# THE AMERICAN ECONOMIC REVIEW

Vol. XXXIV, Number 1 SUPPLEMENT Part 2, March 1944

## PAPERS AND PROCEEDINGS

OF THE

*Fifty-sixth Annual Meeting*

OF THE

## AMERICAN ECONOMIC ASSOCIATION

Washington, D.C., January, 1944

*Edited by the Secretary of the Association*

PRINTED BY GEORGE BANTA PUBLISHING COMPANY

*Publication Office:* 450 Ahnaip Street, Menasha, Wisconsin

*Executive Office:* American Economic Association, Northwestern University, Evanston, Illinois

Inquiries and other communications regarding membership, meetings, and the general affairs of the Association, as well as orders for publications, should be addressed to Dr. James Washington Bell, Secretary of the American Economic Association, Northwestern University, Evanston, Illinois.

Entered at the post office at Menasha, Wisconsin, as second class matter. Acceptance for mailing at special rate of postage provided for in the Act of February 28, 1925, embodied in paragraph 4, section 412, P. L. and R., authorized September 13, 1928.

The *American Economic Review* is sent to all members of the American Economic Association as one of the privileges of membership, $4.00 of the annual membership dues being in payment of a year's subscription to the publication.

*Price, in paper, $1.25*

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## PROCEEDINGS

## PROGRAM OF THE FIFTY-SIXTH ANNUAL MEETING

NOTE: Instead of the customary editorial note on the program, there follows below a summary of the remarks made by President A. B. Wolfe at the meeting of the Executive Committee on January 20, 1944.

Immediately after our meetings in Washington last January I set to work on the program for the next meeting. It was then uncertain, and remained so for some months, whether we could hold a meeting in 1943 or early 1944, or not at all. In consultation with the Secretary and the Executive Committee, various possibilities were canvassed. These included a meeting in Cleveland or some other central point, either before or after Christmas, a meeting just after Labor Day at some eastern resort hotel, and a split-up into regional meetings. No conclusion was reached until June, at which time the President and Secretary met with the Executive Committee of the American Political Science Association at the Shoreland Hotel, Chicago. The political scientists had already decided to hold a meeting, and preferred Washington. They were also desirous of a joint meeting with the economists. After due deliberation, a joint meeting was decided upon, to be held in Washington, D.C., January 20-23. This late date was selected because it would avoid both the holiday travel congestion and the opening of Congress. There was indirectly sufficient assurance that the ODT would not raise objection to a local, or regional, meeting, which would draw no great number of members from a distance. For a time after the Chicago conference, it was thought that regional meetings might be arranged in conjunction with the main meeting in Washington and tied in with it by radio. Whether this could be done or not, it was thought that arrangement could be made with the national broadcasting companies for the broadcasting of some of the main papers. In the end, neither of these possibilities materialized.

Meanwhile I began correspondence with outstanding members of the Association, authorities in their several fields, concerning topics and contributors. On my own authority, I had decided (1) that the program should deal with long-run postwar problems, since preceding programs had dealt with the more immediate postwar situation; (2) that the program should not be confined to purely technical problems, but that to some reasonable extent it should deal with fundamental principles, including the relation of economics to the fundamental values of American democracy; and (3) that we should attempt to have at least one session dealing with the place of economics in American education, and the kind of courses and approach best suited to the contribution which economists, as teachers, or "educators," should try to make to American life.

In July I conferred for a whole day with Professor Marshall E. Dimock, Chairman of the Program Committee of the Political Science Association, and the general outline and arrangement of the joint program were agreed on.

Copies of an early, preliminary, draft of the program were sent to members of the Executive Committee for comment and suggestions. Responses in general were slow in coming in. Nevertheless, it would have been impossible for me to have assembled a program without the help of members of the Executive Committee and others to whom appeals were made.

I did not exercise my authority to appoint a program committee. The reason for this, frankly, was that I thought I could come nearer to getting the kind of program I thought the Association should have this year without a committee. For only one section of the program did I make an exception. I persuaded Professor Simeon E. Leland, of the University of Chicago, to take entire charge and responsibility for the two sessions on public finance, a field which has hitherto been somewhat neglected in our meetings. I desire at this time to express my sincere thanks to Professor Leland for a job well done. I also wish to thank all the many members of the Association who responded to my request for suggestions as to the program.

The program was arranged on the idea that every division of economics is concerned with postwar problems, although not all divisions could be given a place on the program. This was true notably of agricultural economics, which it seemed best to leave over to the president for 1944, and population, for which it proved impractical to find competent contributors who had time to prepare papers. The divisions of the program, as outlined in the preliminary draft, were:

Theory and general applications
The postwar structure of American business
Postwar public finance
Postwar money and banking problems, both domestic and international
Economics and education
Social security
Postwar labor problems
Political economy, political science, and basic values

International trade and regional problems
The postwar legal and economic position of American women

A list of possible topics was submitted to selected men in each respective field, with request that they both express their preferences and suggest other topics. When time came to write to prospective contributors, they were asked to write on specific topics.

The main difficulty in getting up the program was the slowness of correspondents. Early in the year it had been predicted that it would be difficult to secure competent men to write papers. As a matter of fact, it was not. In only one case did a session fail to materialize as desired. That was in the field of economic theory. It was my desire to secure a competent paper on process analysis and economic policy, but although several were appealed to, no one was found who was willing to undertake the task.

In the June meeting with the political scientists in Chicago, and again in the conferences with Professor Dimock in Washington and by correspondence, there was cordial agreement on the general framework of the program. It was also decided to make the joint meeting really joint, and therefore not to list the separate sessions as either economics or political science. This was done on the ground that economics and political science, and also public administration, are so closely allied in present interests and functions that separate labeling was inadvisable.

Aside from this arrangement, there are two minor innovations in the program. One is the symposium by past presidents. Who first thought of this experiment is unimportant, but it seemed that at this juncture in our national history, the twenty-one past presidents of the Association might properly be heard. The specific question of government and private enterprise was submitted to them simply because it seemed to be the question most widely discussed at this time. The second innovation is the devotion of one evening to the address of the president of the American Economic Association. I desire emphatically to disclaim responsibility for this arrangement. I argued in vain against it, and do not feel comfortable with it. But it seemed that three presidential addresses the same evening would be one too many.

Last year our Association met by itself. In former years we have met with the American Statistical Association and a number of other associations. This year we meet with the American Political Science Association and the American Society for Public Administration. The latter Society, however, has scheduled no sessions of its own, rather merging its interests with the other two associations. Without in any way prejudicing the situation for the incoming president, I venture to express the hope that the economists and political scientists will continue for the next few years to meet together, and without other associations. Many associations meeting together mean an unwieldy program, too large audiences at sessions, and a lack of unity in the program as a whole. Besides this, it can be argued that no other two social science associations have in common such intimate interests as the economists and political scientists. Professor Dimock, in his report to the American Political Science Association, as Chairman of their Program Committee, is expressing a similar view.

I wish to express my cordial appreciation and thanks to Professor Dimock, for his unfailing co-operation, his initiative, and his attention to the many details which had to be handled by someone on the ground in Washington, and to Secretary James Washington Bell, without whose experience and guidance no president can be kept on the track. I also express my thanks to Miss Ethel M. Rowe, Secretary of the Department of Economics, Ohio State University, for her unfailing devotion to the heavy load of correspondence incident to the formation of the program.

Note: Numbered sessions are the source of papers published by the American Economic Association.

**Thursday, January 20, 1944**

1:30 P.M. *Executive Committee Meeting, American Economic Association*

8:00 P.M. 1. Postwar International Relations
Chairman: Robert E. Cushman, Cornell University
Papers: J. B. Condliffe, Carnegie Endowment for International Peace; Clarence Berdahl,[1] University of Illinois

**Friday, January 21, 1944**

9:30 A.M. 2. *The Implemental Aspects of Public Finance—I*[2]
Chairman: Stacy May, War Production Board
Papers: Roy Blough, United States Treasury Department; Harold M. Groves, University of Wisconsin

[1] To be published in the *American Political Science Review*.

[2] To be published as a special monograph and issued as a supplement of the June, 1944, number of the *American Economic Review*.

Discussion: William Anderson, University of Minnesota; Walter S. Salant, Office of Price Administration; Gerhard Colm, Bureau of the Budget; Ralph E. Flanders, Jones and Laughlin Machine Company

3. *Political Science, Political Economy, and Values—I*
Chairman: Leon C. Marshall, Washington, D.C.
Papers: Raymond T. Bye, University of Pennsylvania; John M. Gaus,[1] University of Wisconsin
Discussion: Joseph J. Spengler, Duke University; Horace Taylor, Columbia University

*Policy Formation*
Chairman: V. O. Key, Johns Hopkins University
Papers: Harold D. Lasswell, Library of Congress; Ernest S. Griffith, Library of Congress
Discussion: James L. McCamy, Foreign Economic Administration; Harold F. Gosnell, Bureau of the Budget; Stanley K. Hornbeck, Department of State; John B. Blandford, Jr., National Housing Agency

12:30 P.M. 4. *Luncheon Meeting*
Chairman: Joseph S. Davis, Stanford University
Paper: Joseph B. Eastman, Office of Defense Transportation

2:30 P.M. 5. *The Educational Function of Economists and Political Scientists*
Chairman: Arthur N. Holcombe, Harvard University
Papers: John M. Clark, Columbia University; Frank H. Knight, University of Chicago; Robert D. Leigh,[1] Federal Communications Commission; William Anderson, University of Minnesota
Discussion: Carl Swisher,[3] Johns Hopkins University; Roscoe Martin,[3] University of Alabama; Leon C. Marshall,[3] Washington, D.C.; Lester V. Chandler,[3] Amherst College

*Hubs and Spokes for Planning: Congress, the Executive, the Interest Groups*
Chairman: Arthur Macmahon, Columbia University
Thomas Blaisdell, War Production Board; Robert K. Lamb, Congress of Industrial Organizations; E. J. Coil, National Planning Association; John F. Fennelly, Committee for Economic Development; Avery Leiserson, Bureau of the Budget; Helen Fuller, *New Republic;* Congressman Estes Kefauver

6. *Social Security*
Chairman: Ewan Clague, Social Security Board
Papers: Eveline M. Burns, National Planning Association; Edwin E. Witte, Regional War Labor Board, Detroit
Discussion: E. Wight Bakke, Yale University; Emerson P. Schmidt, Committee on Economic Development

6:00 P.M. *Dinner Meeting*
Chairman: Amos E. Taylor, Bureau of Foreign and Domestic Commerce
Paper: Leon Henderson, Research Institute of America

8:00 P.M. *Presidential Address*[4]
Chairman: Edwin G. Nourse, Brookings Institution
Paper: A. B. Wolfe, American Economic Association

**Saturday, January 22, 1944**

9:00 A.M. *Business Meeting, American Economic Association*

9:30 A.M. *Problems of Bureaucracy in Business, Labor and Government*
Chairman: Pendleton Herring, Harvard University
Lincoln Gordon, War Production Board; David Lilienthal, Tennessee Valley Authority; Herbert Emmerich, National Housing Authority; John Corson, Social Security Board; Wayne Coy, Bureau of the Budget; Lloyd Reynolds, Johns Hopkins University; Joseph Juran, Lend-Lease Administration; Clinton Golden, War Manpower Commission

7. *Political Science, Political Economy, and Values—II*
Chairman: B. F. Haley, Department of State
Papers: Arthur Salz, Ohio State University; Herbert von Beckerath, Duke University; Francis G. Wilson, University of Illinois
Discussion: Frank D. Graham, Princeton University; Wesley C. Mitchell, Columbia University; Frank H. Knight, University of Chicago

[3] No manuscript received.
[4] To be published in the March, 1944, number of the *American Economic Review.*

*Administrative Implications of Broadening United States Participation in International Affairs*
Chairman: Luther Gulick, Foreign Economic Administration
W. E. Mosher, Foreign Economic Administration; Rupert Emerson, Lend-Lease Administration; Eugene Staley, Foreign Economic Administration; Brig. Gen. C. F. Robinson; Paul H. Appleby, Department of Agriculture; Walter H. C. Laves, Bureau of the Budget; Harry D. White, Treasury Department; Walter Sharp, College of the City of New York; Louis Brownlow, Public Administration Clearing House; Adolf A. Berle, Department of State

*Public Personnel after the War*
Chairman: Luther Evans, Library of Congress
Arthur Flemming, Civil Service Commission; Kenneth Warner, Foreign Economic Administration; Floyd Reeves, University of Chicago; Lt. Commdr. James M. Mitchell (formerly Civil Service Assembly); John McDiarmid, Civil Service Commission; Samuel May, University of California

8. *The Structure of Postwar American Business*
Chairman: W. H. S. Stevens, Washington, D.C.
Papers: Theodore N. Beckman, Ohio State University; Theodore O. Yntema, University of Chicago; Julius Hirsch, New York City
Discussion: Edwin G. Nourse, Brookings Institution; Sumner H. Slichter,[3] Harvard University; Chalmers Hamill, Department of Justice

12:30 P.M. *Luncheon Meeting*
Chairman: Roscoe Martin, University of Alabama
Paper: Congressman Robert Ramspeck

2:30 P.M. *Judicial Control of Administration*
Chairman: Charles Hyneman, War Department
Papers: Carl McFarland, Secretary, American Bar Association's Conference on Administrative Law; Charles Collier, George Washington University; Kenneth Cole, University of Washington
Discussion: F. F. Blachly, Brookings Institution; Avery Leiserson, Bureau of the Budget

*Civil Liberties in Wartime*
Chairman: Harold W. Stokes, University of Wisconsin
Papers: Max Lerner, Williams College; Benjamin F. Wright, Harvard University; Victor W. Rotnem, Department of Justice
Discussion: Thomas M. Cooley, II, Department of Justice; James Fesler, War Production Board

9. *The Implemental Aspects of Public Finance—II*[2]
Chairman: Sumner H. Slichter, Harvard University
Papers: Carl Shoup, Columbia University; Simeon E. Leland, University of Chicago
Discussion: A. P. Lerner, New School for Social Research; Simon S. Kuznets, War Production Board; Dan T. Smith, Harvard University; Lawrence H. Seltzer, Wayne University

10. *Postwar Labor Problems*
Chairman: William M. Leiserson, National Mediation Board
Papers: Carroll R. Daugherty, War Labor Board; George W. Taylor, War Labor Board; Lewis L. Lorwin,[5] Washington, D.C.
Discussion: David Kaplan, International Brotherhood of Teamsters; David A. McCabe, Princeton University; Ernesto Garzala,[3] Pan-American Union; Robert J. Watt,[3] American Federation of Labor

4:45 P.M. *Business Meeting, American Society for Public Administration*
5:45 P.M. *Buffet Supper, American Political Science Association*
6:30 P.M. *Business Meeting, American Political Science Association*
8:00 P.M. *Presidential Addresses*
Chairman: Frederic A. Ogg, University of Wisconsin
Papers: Robert E. Cushman, President, American Political Science Association; Louis Brownlow, President, American Society for Public Administration

**Sunday, January 23, 1944**

9:30 A.M. *International Policing*
Chairman: Quincy Wright, University of Chicago
Papers: Senator Joseph H. Ball; Arthur O. Lovejoy, Universities Committee on Postwar International Problems

[5] To be published in March issue of *World Economics.*

Discussion: Grayson Kirk, Yale University; Ely Culbertson, New York City; Payson Wild, Harvard University; Theodore P. Wright, Aircraft Resources Control Office

*A Federal Solution for Europe*
Chairman: Arnold J. Zurcher, New York University
Papers: Arnold Brecht, New School for Social Research; Count R. N. Coudenhove-Kalergi, New York University; Senator Elbert D. Thomas; Egon Ranshofen-Wertheimer, American University; Feliks Gross, Central and Eastern European Planning Board

*Treaty-Making*
Chairman: Edwin Borchard, Yale University
Papers: Senator John A. Danaher; Denna Fleming, Vanderbilt University; Walter F. Dodd, Chicago
Discussion: David Levitan; H. M. Clokie, University of Manitoba

11. *Postwar Domestic Monetary Problems*
Chairman: Eward S. Mason, Office of Strategic Services
Papers: C. R. Whittlesey, University of Pennsylvania; Karl R. Bopp, Federal Reserve Bank of Philadelphia.
Discussion: William W. Tongue, Federal Reserve Bank of Chicago; Lawrence H. Seltzer, Wayne University

12. *Economic Theory in Relation to the Long-Run Postwar Situation*
Chairman: Albert G. Hart, United States Treasury Department
Papers: Z. Clark Dickinson, University of Michigan; Morris A. Copeland, War Production Board
Discussion: R. A. Gordon, University of California; John H. G. Pierson, Bureau of Labor Statistics

13. *International Trade*
Chairman: C. F. Remer, Office of Strategic Services
Papers: Jacob Viner, University of Chicago; Corwin D. Edwards, Department of Justice; Percy W. Bidwell, Council on Foreign Relations
Discussion: Arthur R. Upgren, Federal Reserve Bank of Minneapolis; Eugene Staley,[3] Foreign Economic Administration

12:30 P.M. *Luncheon Meeting*
Chairman: Clyde Eagleton, New York University
Paper: Sir Arthur Salter

2:30 P.M. 14. *Regional Problems*
Chairman: Kenneth Colegrove, Northwestern University
Papers: W. L. Holland, Institute of Pacific Relations; Dana Munro,[1] Princeton University
Discussion: S. R. Chow[3]; George Wythe, Department of Commerce; Amos E. Taylor, Bureau of Foreign and Domestic Commerce; Harold M. Vinacke,[3] University of Cincinnati

15. *The Postwar Legal and Economic Position of American Women*
Chairman: Eveline M. Burns, National Planning Association
Papers: Rebekah Greathouse, New Orleans; Mary Anderson, Women's Bureau, Department of Labor
Discussion: From the floor

*Postwar Requirements for International Functional Organizations*
Chairman: Walter H. C. Laves, Bureau of the Budget
Senator Joseph H. Ball; Senator Harold Burton; Congressman Walter Judd; Senator Carl A. Hatch; Senator Lister Hill; Arthur Sweetser, Office of War Information; Donald C. Stone, Bureau of the Budget; Philip C. Jessup, Columbia University

16. *International Monetary Problems*
Chairman: E. A. Goldenweiser, Federal Reserve Board
Papers: John H. Williams, Harvard University; Howard S. Ellis, University of California
Discussion: Redvers Opie, British Embassy; Frank D. Graham, Princeton University

*Council Meeting, American Society for Public Administration*

5:45 P.M. *Executive Committee Meeting, American Economic Association*

7:00 P.M. *Business Meeting, American Economic Association*

8:00 P.M. 17. *Symposium by Past Presidents of the American Economic Association*
Chairman: James Washington Bell, Northwestern University
Topic: What should be the relative spheres of private business and government in our postwar American economy?

THE purpose of the American Economic Association, according to its charter, is the encouragement of economic research, the issue of publications on economic subjects, and the encouragement of perfect freedom of economic discussion. The Association as such takes no partisan attitude, nor does it commit its members to any position on practical economic questions. It is the organ of no party, sect, or institution. Persons of all shades of economic opinion are found among its members, and widely different issues are given a hearing in its annual meetings and through its publications. The Association, therefore, assumes no responsibility for the opinions expressed by those who participate in its meetings.

JAMES WASHINGTON BELL
*Secretary*

# POLITICAL SCIENCE, POLITICAL ECONOMY, AND VALUES

## SOME CRITERIA OF SOCIAL ECONOMY

*By* RAYMOND T. BYE
*University of Pennsylvania*

The study of economic phenomena has been called by various names, among which are political economy, national economy, social economy, and economics. Of these, I think that the term social economy is for some purposes the most appropriate, because it stresses the social function which it is the task of the economic process to perform. That function is to economize in the use of the scarce means of production, so that they will go as far as possible toward satisfying the infinite multitude of human wants. In a social order that is becoming increasingly planned and controlled, instead of being left to the play of spontaneous forces, it is important to keep this function in mind; for if planning and control are to be done intelligently, we must have a clear conception of what social economy is. Not until this notion is carefully defined, and its broad implications explored, can social control be directed toward objectives that are consistent and wise.

The concept of social economy thus lies at the very heart of applied economics; yet it has been relatively neglected by economists. It is, therefore, appropriate to give it further attention. I cannot hope to do full justice to so large a subject in this short paper, but I shall attempt to outline some general criteria of social economy which I think may offer an approach toward a valid conception. I believe that there are three basic principles involved, and a number of subordinate principles, from which detailed specific criteria can be developed. The basic principles I call the principles of *want selection*, of *surplus utility*, and of *least costs*, respectively. The subordinate principles will be developed as I proceed.

The principle of want selection may be stated as follows: Wants should be provided for in the order of their importance. To put it negatively, though perhaps more cogently: no want should be satisfied if a more important want is thereby excluded. In a world of scarcity, means of production cannot be applied in one direction without giving up some possible alternative. It is, then, clearly wasteful to dissipate resources in the satisfaction of trivial wants, if more important ones are thereby sacrificed.

While this proposition will no doubt command general assent, it is difficult to apply it in concrete cases because we lack any reliable classification of wants in the order of their importance. It is probably

not possible to formulate a scientifically valid classification in the present state of our knowledge, and it may be argued that the problem is one of moral values that must always remain in the domain of transcendentalism and metaphysics; yet I believe that a systematic effort to catalogue a hierarchy of needs would not be altogether fruitless. It would not be difficult to establish broad categories of necessities, comforts, and luxuries that would command fairly general approval. Most persons would agree that there are certain basic requirements of food, clothing, and shelter that are more important than such frivolities as race horses and pleasure yachts. Even within such broad categories, some further classification would probably be possible. For example, in the category of food, bread and water would clearly take priority over pretzels and champagne. Moreover, a great deal of research is going on which may eventually provide an objective foundation for this principle of want selection. Economists are studying standards of living; food experts are learning about nutrition; sociologists are developing standards of housing; physicians and psychologists are producing valuable findings concerning the organic and emotional needs of human beings. Out of such research, it should be possible to set up reasonable requirements for physical and mental health, and out of these it should be possible eventually to construct a general classification of wants in the order of their importance.

A special case of the principle of want selection involves the question of whose wants are most important. Should everyone be treated alike, or are there some persons so much more valuable to society that their needs should take precedence over other's? In other words, should we have equality or inequality of incomes, and if the latter, how much inequality? I suggest that the answer to this question can be found in four subordinate principles, which may be regarded as corollaries to the principle of want selection. The first (which may be called the principle of a guaranteed minimum) is that the basic requirements for all should be met before luxuries are allowed to any. This principle has already been incorporated in the poor laws and social security systems of most enlightened communities, and will be progressively expanded in the future. The second corollary (which I call the principle of developing capacities) is that any excess of social income over the basic requirements should be apportioned in such a way as to provide the fullest development of socially desirable latent capacities in each individual. This calls for some inequality—for preferential treatment of those members of society who have special skills or talents that can contribute something peculiarly worth while to the social well-being. The third corollary (which may be called the principle of incentive) is that reward should vary with the socially useful productive

achievement of the individual. It is not enough that the latent capacities of each should be developed; it is important to stimulate the individual to use his talents in socially desirable ways. The principle of incentive is designed to accomplish this. Finally, in wealthy societies it may be found that there is a surplus of social income even beyond what is necessary to provide basic requirements, development of capacities, and incentive to effort. This surplus should not be dissipated in extravagant expenditures for a lucky few (as it now is), but should be devoted to projects for the common good. Hence, I suggest that this principle be designated as a fourth corollary, which may be called the principle of social surplus for the common good.

Here again, I believe it possible to develop reasonably objective standards for the application of these several subordinate principles. Basic requirements can be determined by cost of living, nutrition, and health surveys; capacities can be discovered by psychological aptitude tests; the incentives necessary to call forth productive effort can be ascertained by experimentation with different types of wage systems in industrial plants, and by the experiences of countries with collective systems, such as the Soviet Union. Findings from these sources will afford a basis for further social experiments on which a pragmatic program following the principles here outlined can be based.

Another special case of want selection concerns the comparison of present and future needs. How much should be sacrificed in the present for the sake of benefits thereby made possible in the future? It is clearly advantageous to sacrifice some want satisfactions now in order to provide equipment that will increase the output of industry later. The progress of civilization depends very largely upon this process of saving and investment; but it may be possible to go too far in this direction, so that the future gains do not compensate for the present abstinence. Can we set up any criterion for attaining a correct balance between present and future? I am unable to offer a definite solution to this problem, but I suggest three principles that may be applied to it. The first (which may be called the principle of capital maintenance) is that the fund of capital should be maintained intact; depreciation should be replaced as fast as it occurs. This is the irreducible minimum of provision for the future; a progressive economy will go farther and allow for capital increase. The second principle states that, in a surplus economy, provision for the future should be made out of the social surplus; there need be no sacrifice of the basic requirements. This may be called the principle of invested surplus. The third principle deals with the mathematical relationship that should prevail between the size of the surplus and the amount of investment; but I am unable to satisfy myself as to what this relationship should be. Perhaps the rate of saving

should progress with the surplus, but it might be argued that it should be regressive. A society whose income is increasing can afford to devote a larger proportion to provision for the future, but its need for such provision becomes less acute. Possibly the rate should increase until a certain level of prosperity has been reached, and then decline.

These various corollaries will suffice to show the ramifications of the broad principle of want selection. I shall therefore turn to my second basic criterion, which I have called the principle of surplus utility. This can be worded as follows: The production of any good should be carried on only so long as its utility exceeds the disutility occasioned by its production. I use the terms utility and disutility, not in a hedonistic sense, but broadly, as a neat way of characterizing the antithesis between benefits and sacrifices that is basic in all economic activity. I mean something similar to Hobson's contrast between human utility and human costs. My point is that goods should yield a surplus of something worth while, sufficient to overbalance the sacrifices incurred in creating them.

The want satisfying power of some goods is so small, in relation to the sacrifices of onerous work, personal injury, impaired health, or loss of leisure associated with their production, that they are not worth producing at all. Moreover, it follows from the law of diminishing utility that even the most beneficial goods can become so plentiful that the extra gain to be derived from a little more of them is not worth the extra effort required to produce them. When this point has been reached, it would be social waste to go any further. Application of this principle involves such matters as the proper length of the working day, the health and safety of workers in industrial establishments, and the conditions which should govern the employment of women and children in industry. It also raises questions of the qualitative and quantitative contribution of different goods to the general welfare.

We here encounter a basic difficulty because we have no measurable unit of utility or disutility. It is a disconcerting fact that the economist lacks any standard measure of these, his most fundamental elements. In the absence of such units, we must fall back partly upon judgment and common sense in dealing with the principle of surplus utility. Nevertheless I think it may be possible to develop objective measures of some of the phenomena with which this principle is concerned. For instance, it is possible to ascertain the effects of longer and shorter working hours on production, as well as on the health—and to some extent the morale—of workers. Also, the costs of industrial accidents, disease, and old age can be counted in pecuniary terms. These things measure certain aspects of disutility. It is when we come to measure the utilities embodied in goods that we meet with the greatest difficulty; but I do not

despair of finding eventually some way to evaluate these with a considerable measure of objectivity.

There is a corollary to the principle of surplus utility which may be called the principle of full utilization. This states that every productive resource that is capable of yielding a surplus of utility over disutility should be kept fully employed, except when needed as a reserve for future contingencies. This is another way of saying that unemployed labor and capital represent social waste. It is a waste so serious in contemporary society that this principle might perhaps be elevated to a place co-ordinate with the other three basic principles. Logically, however, it seems to me to belong where I have placed it. The principle is self-explanatory and needs no further elaboration; but this brevity in treatment should not be taken as belittling its importance. Failure to give effect to the principle is one of the most conspicuous weaknesses of our economy, revealing faulty co-ordination and lack of balance.

My third broad criterion of social economy is the principle of least costs, which may be stated in this way: Each good should be produced in the manner that requires the least amount of scarce resources. In a world of scarcity, the use of resources for a given product requires the sacrifice of some other useful product that might have been obtained in its stead. This sacrifice can be reduced by the adoption of methods of management and technology that minimize the requirements of each industry for land, labor, and equipment. It is the familiar problem of industrial efficiency versus industrial waste. Two subordinate principles are involved in this problem.

The first I may call the principle of combination (which is closely related to Marshall's well-known principle of substitution). It is that the agents of production should be combined in such a way as to minimize the use of those which are most scarce and to maximize the use of those which are most abundant. The scarcer agents (such as highly skilled labor) should always be reserved for those uses in which they are most indispensable, the more abundant types (such as unskilled labor) being employed wherever it is possible to do so.

In attempting to apply this principle, we are again confronted by difficulties of measurement. In the first place, the various productive factors differ in kind, so that they have no common denominator. An acre of land is not comparable to an hour of labor, and the difference between a skilled artisan and a common laborer is one of quality rather than of quantity. Furthermore, scarcity is not an absolute magnitude; it is a relative concept. A thing is scarce in relation to the demand for it. Yet the market solves these difficulties by the device of money, and it should be possible to do it by some other means of evaluation. A clue to the solution is afforded by the principle of opportunity costs,

which assays the importance of a productive agent according to the various alternative uses to which it can be put. This links the present principle to the principle of want selection that was discussed above. From a schedule of wants, arranged in the order of their importance, schedules of need for the different productive agents could be derived. This could be compared with a schedule of supplies of the agents, classified into uniform categories. For instance, lands could be graded according to fertility, climate, and distance from markets, and labor according to levels of skill. It should then be possible, by such a comparison, to express the scarcity of each agent in relation to the need for it by a system of weights or points, not unlike the points of a rationing system. The most economical combination of agents in a given productive operation would be the one which required the lowest number of points.

The second principle subordinate to the general criterion of least costs may be called the principle of maximum yield. It is that, when the most economical combination of agents has been found, output per unit of that combination should be maximized. Since output can readily be measured in quantitative terms, the application of this principle involves no theoretical difficulties. It is simply a matter of applying efficiency methods in such phases of industrial management as plant layout, time and motion studies, production planning, personnel work, and the like. Such methods will reduce the drain of each producing establishment on the pool of scarce resources and release as much as possible of them for other products, thereby increasing the social income.

Such are the principles upon which the attainment of social economy appears to depend. No doubt they could be stated differently, and further reflection will probably reveal some additional principles, as well as needed qualifications. However, I believe that we have here the elements of a working concept.

I anticipate that there may be three types of objection to this analysis. The first would come from those economists of laissez faire leanings who, enamored of the symmetry of the spontaneous price system, would hold that it constitutes a sufficient guide to social economy, without the necessity for other formal criteria. Demand, they would say, is a sufficient register of human wants or utilities, costs an accurate measure of disutilities and scarcities; the order of priority among the wants of different persons is correctly determined by the marginal productivity system of distribution; present and future needs are balanced by the device of the interest rate; and so on. More than that, they might argue that prices constitute the only possible common denominator of such heterogeneous things as utilities, sacrifices, and scarcities; therefore it is futile to look outside of the price system for criteria of econ-

omy. So, my whole discussion is unnecessary and futile. To this I would reply that such reasoning begs the whole question. How can we know whether or not the price system measures these things correctly, how can we be sure whether or not it is a satisfactory guide for production to follow, unless we have some external criteria with which to test it? It is precisely to make such a test, among other things, that a careful elaboration of the concept of social economy is needed. I believe that the price system can be judged independently by the principles I have set forth, and that if it is examined in the light of these criteria, it will be found defective in a number of important respects.

A second type of objection may be that the principles here set forth are too vague and intangible for practical application. Utilities, disutilities, and scarcities cannot be measured; basic requirements and surplus are subjective concepts; capacities and incentives are matters of uncertainty. I would not make light of these difficulties; but I would point out that they are inherent in the nature of the problem. It is admittedly elusive; but there is no use in running away from it on that account, for we cannot escape it if we will. I am not sure that these notions are any more intangible and imponderable than were the concepts of the atom and the electron when first conceived by the physicists, or the idea of the gene in the minds of contemporary biologists. We must first conceive of the ideas that we would like to use; then hunt for means of giving them objective reality. I have tried to make some contribution to the first of these steps. At the same time, I have thrown out hints as to how the principles I have set forth may be developed more concretely. I believe that if we go forward resolutely in search of methods for accomplishing this, we shall make progress. It is surprising what empirical procedures can do toward uncovering subtle theoretical relationships in the actual world, when they are directed toward that end with intelligence and imagination.

Finally, there is a school of scientific purists who hold that it is not the province of the economist to deal with ends or purposes. They maintain that these are matters of moral values that lie outside the realm of science; therefore they should be left to philosophers and statesmen. The economist, being a scientist, should confine himself to the development of means for attaining the ends set forth by these mentors of the public welfare. I am unable to accept this viewpoint. To be sure, there is a science of pure economics that is not concerned with ends or purposes. I believe strongly in the value of this branch of economics; and I have no quarrel with those who prefer to specialize in it to the exclusion of other branches. But there is also an applied economics which is concerned with the promotion of the social welfare. It cannot be consistent or meaningful until the economic aspects of that welfare are ex-

## DISCUSSION

J. J. Spengler: I never participate in a discussion of this sort but that I am reminded of Professor Ruggles' story of the farmer who, after having listened long and patiently to an agricultural journal's salesman's account of its educational virtues, remarked: "I don't need it. I ain't farmin' now half as well as I know how." I have the impression that the putative statesmen charged with the manipulation of the economy are not making half as much use as they might of existing criteria of social and political economy.

If we would appraise the set of criteria which Professor Bye has proposed we must first establish superior principles in terms of which evaluation is possible. Of the criteria set down as guiding principles for the social economy, or as yardsticks wherewith to measure the practical efficacy of that economy, we must require qualities which may be embodied in two principles: (1) operational and administrative feasibility; (2) internal and external consistency. And of him who would develop, appraise, or apply the guiding criteria, we must require that he move outside the pound within which economics is neutral as to ends and is concerned only with "human behavior as a relationship between ends and scarce means which have alternative uses."

1. By operational feasibility of criteria I mean their amenability to formulation in comparatively concrete and quantitative terms. By administrative feasibility I mean their suitability as bases for action on part of those in a position to act.

2. (a) By internal consistency I mean the quality in virtue of which socio-economic criteria severally conduce to harmonious results, or direct movement along harmonious paths. This quality is lacking when one socio-economic criterion leads to a goal somewhat different from that to which another such criterion leads. One cannot, for example, employ as unqualified objectives, or criteria, the maximization of both employment and per-worker output; for employment may be purchased at the expense of per-worker output. Given proper qualification, however, these two criteria may be made conditionally consistent.

2. (b) External consistency exists when socio-economic criteria are in harmony: (1) with the criteria employed in the noneconomic means segment of the complete means-end chain of a society; that is, with criteria in use in the technological and political realms, which, together with the socio-economic realm, constitute the means sector of a society; and (2) with the system of ultimate values and ends in effect in a society. These two modes of external consistency are interdependent; if the second is present in a marked degree the first almost certainly will be.

The content, actual and potential, of the system of ultimate ends and values of a society is well suggested in Parsons' restatement of Pareto's version of the sociologistic theorem:[1]

> The actions of the members of a society are to a significant degree oriented to a single integrated system of ultimate ends common to these members. More generally the value element in the form both of ultimate ends and of value attitudes is in a significant degree common to the members of the society.

[1] *The Structure of Social Action* (New York, 1937), p. 707.

These ultimate ends and values attitudes, if common to the members of society in a significant enough degree, hold them together just as the cement of discipline held together the legions of the early Roman Empire. They serve, if strong enough, to assign a proper, yet circumscribed, role to economic, to political, and to technological behavior, and to establish and preserve a high degree of consistency between the criteria employed in these three domains. If these ultimate ends and value attitudes are not sufficiently strong and well integrated—and this is the case today—the criteria employed in the economic realm will not tend to consist completely with those in effect in the political and technological realms, unless the formulators of criteria sedulously strive after such consistency.

We can no longer suppose, with the utilitarians, that ultimate ends are both random and harmonious, and so avoid the problem Thomas Hobbes proposed to solve through the establishment of "a compelling power to keep" all men "in awe" and thereby preserve unity and order. The separate realms of economics, of politics, and so on may be bounded; and criteria peculiar to the subject matter of each may be laid down. But, since the behavior of individuals and of groups cannot be sequestered into the purely economic, the purely political, and so on, and since man's behavior in any one of these provinces of action is interconnected with that in other of these provinces, socio-economic criteria must be laid down with an eye to the relations between these criteria and the criteria obtaining in other provinces of action. This approach is important from the point of view of analysis and understanding; it is compelling from the point of view of operational and administrative feasibility.

Each of Professor Bye's criteria should be subjected to the tests of feasibility and consistency. Because within the time available such a testing is out of question, my comments will be less detailed than I prefer.

To the proposition that, in a world of scarcity, first order wants should be given priority, exception cannot be taken. But to the suggestion that a hierarchy of needs be set up, one cannot assent without qualification; for ophelimity and utility do not always coincide. The feasibility of such a proposal turns on conditions which lie largely outside the domain of economics. "The acts which constitute a system of living are generally integrated about some dominant characteristic. Each single group of acts, such as food, clothing, and housing is pervaded by the values of the whole social system."[2] This dominant characteristic reflects the system of ultimate ends and value attitudes. If this system becomes adequately integrated and sufficiently diffused through the membership of a society, a comparatively ordered hierarchy of needs would become manifest; in most societies, in fact, at least the rudiments of such a system are discoverable. Yet, even given such a hierarchy, its component needs would as a rule be *generic* rather than *specific* in character, each genus susceptible of satisfaction in a multiplicity of ways.[3] Only in the field of therapeutics would need be definite and satisfier specific. Nakedness would continue to have manifold covers, and hunger, multiple appeasers; choice of satisfier would continue to be dictated by income, price, technology,

[2] C. C. Zimmerman, *Consumption and the Standard of Living* (New York, 1936), p. 571.
[3] See my *France Faces Depopulation* (Durham, 1938), pp. 274 ff.

and cultural milieu, except insofar as the state, itself an expression of the ultimate value system, intervened (say) to stimulate natality, to provide goods and succor in kind, or to shunt resources into certain employments. In our world, with its loosely integrated system of ultimate ends and value attitudes, with its accentuated social mobility, with its stress upon sumptuary individualism, and with its small emphasis on living itself and on what Marshall called activities, *de gustibus non est disputandum* still holds; short of a modification and integration of our system of ultimates, and of the associated system of living, little in the form of the establishment of a conduct-determining hierarchy of needs is accomplishable within the domain of economics as such.

The principles suggested as corollaries to that of want selection are acceptable only if qualified. Had hunger-ridden societies, such as those of which Malthus wrote at the close of the Age of Hunger, practiced fully the principle of a guaranteed minimum, they might very well have progressed much more slowly than they did. Furthermore, granting that a minimum may readily be provided, the community must impose a corresponding obligation to itself upon the recipients. The principle of developing capacities must be carefully qualified; for example, were it to produce more postulants than places, or were it to inculcate goals generally beyond reach of those whose capacities were developed, it might prove its undoing.[4] The specific content of the principle of incentive would have to be determined in light of the noneconomic components of the social system; and it would have to be administered in such manner as not to interfere with correct resource allocation. The principle of social surplus requires to be integrated with the principle of invested surplus and the principle of full utilization, and perhaps also with the principles of guaranteed minimum and incentive; for these principles appear to be interconnected in their results and to have bearing upon the general principle of surplus utility.

The principle of surplus utility appears to be implicit, albeit imperfectly, in modern social systems. The establishment of the corollary condition of full utilization—which I take to mean the absence of both complete and disguised unemployment—should contribute in large measure to the realization of this principle. Its realization in a private enterprise economy may be fostered, also, especially on the side of supply, through the effectuation of legislative and other arrangements which make incident upon the discretionary entrepreneur all the costs entailed in producing or distributing a given good or service.[5] Occupations and industries may be graded roughly in terms of the visible human costs mentioned by Professor Bye and these grades may be utilized, together with the present value of actual and prospective money earnings in said occupations, to determine whether it is in order to introduce arrangements of the type just mentioned. How far action is possible or feasible on the demand side turns largely upon the resolution made of the principle of want selection.

[4] See George Morgan, "Human Equality," *Ethics*, LIII (1943), pp. 115 ff.; R. K. Merton, "Social Structure and Anomie," *American Sociological Review*, III (1938), pp. 678 ff.

[5] Cp. M. A. Copeland, in R. G. Tugwell, *The Trend in Economics* (New York, 1924), pp. 105 ff.

From the principle of least costs as such one cannot dissent. It must, however, consist with the political situation. The maintenance of stability and order must take precedence over rational economizing. If an economy is shot through with unemployment, it is more important to reduce it as much as possible, even at the expense of violating the principle of least costs, than to pursue the principle of least costs at the expense of social tumult. To the suggestion that we employ points and weights, analogous to those used in rationing systems, to translate the corollary principle of combination into action, I must object. It seems much simpler to use the existing quantitative price system, co-mixed with judgment; at most, points and weights arrived at somewhat independently of the price system might be used to check on the values established under the price system.

I shall close my remarks by saying that human history suggests that every social cure begets its own collective disease. Let us suppose that we successfully formulate and execute Professor Bye's criteria. Our experience since Pearl Harbor indicates that this country can normally provide a national dividend in the neighborhood of 150 billion dollars per year. We may have to cut down the replacement period for housing and other forms of construction to accomplish this, but it can be done. Should we prove successful in applying Professor Bye's criteria fully, the national dividend will swell to even greater proportions. Under these circumstances the element of leisure will bulk very large in the American system of living. Are we ripe for that leisure? Can we stand what one economist has called the long Byzantine afternoons? Have we yet discovered a moral equivalent for work and effort and sacrifice?

HORACE TAYLOR: I believe that Mr. Bye has accurately anticipated the lines that criticism of his paper may follow. He has indicated three types of objection: (1) that his "principles of social economy" already have been worked out fruitfully in theoretical systems which treat price relations in free markets; (2) that it is not appropriate for an economist, *qua* scientist, to express value judgments; (3) that his "principles are too vague and intangible for practical application." I shall consider briefly each of these three lines of attack.

The first objection, that Mr. Bye's principles are redundant because they already have been developed in the analysis of free-market processes, seems to me implicit but futile. It is an interesting fact that the names given by Mr. Bye to his "three basic principles of social economy" are similar to the names of concepts commonly used by liberal economists in their descriptions of demand and supply, of utilities and real costs, as they operate (or would operate) in free markets. It is dangerously easy, therefore, to jump to the conclusion that the builders of laissez faire theoretical systems already have done the job that Mr. Bye proposes, and that they have done it in the only way that will yield measurable results; viz., through the study of price relationships.

Such an assumed identity would be false and would obscure the issue. The precedence of superior wants over lesser ones, the optimum excess of utility over disutility, and the most productive uses of resources, are treated in

laissez faire systems as normal results in free markets. Mr. Bye, in offering the same principles as bases for criteria by which to judge any economic system, clearly implies that the existing market economy does not yield results in close conformity with the criteria he suggests. He even has "good reasons for suspecting that the existing price system falls short of meeting the criteria of economy" he has developed.

Mr. Bye does not tell us what these reasons are; indeed, he is under no obligation to do so. It may be observed, however, that his position has been given strong support by some of the economists who have studied relationships of demand, supply, and price in free markets. Thus it has been demonstrated mathematically (as, e.g., by the acceleration principle) that the existing economy must (and that a laissez faire economy would) for purely mechanical reasons, fail of close conformity with two of Mr. Bye's principles: the second (surplus utility) and the third (least costs).

Alfred Marshall, in his mathematical demonstration that maximum benefit is derived from transactions in a commodity whose demand and supply are in equilibrium, is at pains to show the limitations of what he has proved. He makes it explicit that the maximum benefit so derived is simply the maximum permitted by the conditions existing in the particular market. He goes on to show that a larger maximum could be gained if income were appropriately redistributed, or if use were made of appropriate taxes and bounties. This is strong evidence that Mr. Bye's first principle (want selection) finds no complete fulfillment in the existing market system, and also that it would not be so fulfilled in a laissez faire economy.

I believe that the second suggested line of possible criticism (viz., that it is no part of an economist's business to set up value judgments) can be dealt with fairly briefly. I know that there are many among us who share an uncomfortable suspicion that some workers in economics are more conscious of the limits of the field in which they work than they are of the insistent problems that it contains. For my own part, I agree with Mr. Bye that "the economist shirks his duty if he does not contribute what he can toward setting up satisfactory criteria for economic action."

Beyond that, it seems to me obvious and inescapable that each of the principal contributors to our body of economic theory has commenced with a set of "criteria of social economics"; i.e., with a set of value judgments concerning the economic future of society. To Adam Smith, the adoption and maintenance of the principle of laissez faire was a means to the end of maximizing a nation's wealth. Ricardo advocated economic liberty as a way of enhancing the material welfare of people in a somewhat rigidly limited economic universe. For me to offer further examples to this audience would be an impertinence.

In turning now to the third suggested line of criticism (viz., that Mr. Bye's "principles are too vague and intangible for practical application") I suggest a change of terms. Instead of considering "vagueness" and "intangibleness," I prefer to apply to these principles the test of "effectiveness." By effectiveness I mean to propose a somewhat crude teleological criterion for criteria. One fundamental question then becomes: Are the principles developed by Mr. Bye capable of administration in the sense that comprehensive policies

can be designed for the attainment of measurable results? I can conclude only that they are not.

An alternative set of criteria which appears to me to be superior as regards administration is: (1) full employment; (2) optimum output; (3) a minimal living standard. These criteria are vague only in the sense that they carry a large content that is only implicit; they are specific in that they refer to definite ends to be attained, and concrete in that they would apply to measurable results. They could be developed at considerable length, but are so familiar that merely to mention them will suffice for the present purpose. They appear to include much that is contained in Mr. Bye's suggestions. It is equally apparent that they differ in some respects which are broad, and others which are subtle. I believe that I should not disagree with Mr. Bye as to what these differences are, but I should seek to justify the differences on the grounds of the superior effectiveness of the criteria I offer. I should contend, for one thing, that these criteria lend themselves to administration.

Another ground on which I believe that the criteria I suggest are more effective than Mr. Bye's is their closer consistency with the current trends of economic knowledge and economic thinking. Effectiveness requires that criteria be consonant with prevailing approaches to the problems that are involved. Consider, for example, the great volume of recent studies in which the results to be attained through changes in the volume of monetary circulation have been the principal objects of concern. These studies point the way to influencing incomes and prices, production, and consumption. I admit that, from the point of view of Mr. Bye's criteria, they are crude. It is clear that they leave want priorities, utilities, and real costs to fend for themselves. Yet they represent our farthest advance on at least one frontier of economic knowledge and economic thinking.

I hope it is clear that I am not, in this discussion, denying the validity of the concepts of want priorities, utilities, and real costs. They are, in my judgment, extremely useful concepts. They are useful, at least, with reference to the problems they were designed to deal with. In the prevailing state of economic knowledge, these are problems of how people behave in their exchange relationships. I share Mr. Bye's expectation that empirical study will give greater concreteness to elements in economic analysis which now can only be regarded as "subjective factors." As I see it now, the most that we can hope is that this greater concreteness will be achieved "in the long run." And here I can only cite Keynes's prophecy that in the long run we all will be dead.

This brings me to the last of the grounds on which I maintain that the criteria of social economy which I suggest are superior in effectiveness to those offered by Mr. Bye. It is simply a new incarnation of something that always has plagued economists: the time factor. Economic change is going on with bewildering rapidity. Standing by are contending groups of economic planners, most of whom are not professional economists. These groups have little interest in the subtleties of ultimate criteria for social economy, but they have much interest in organized action. They are intellectually capable of acting in short periods of time and without much regard to "the long run." Their strategic advantage is that they, unlike ourselves, are not confused with too many ideas.

# THE PRESENT POSITION OF ECONOMICS

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## I

One hundred years ago, in 1842 to be exact, Alfred Marshall was born, to be the outstanding and last representative of encyclopedic economics and the teacher of several generations of economists in various countries. The American Economic Association commemorated the centenary of a master-mind and paid tribute to his memory.

It is not incumbent on me to offer an appraisal of Marshall's work. I shall use it, however, as a convenient landmark from which to take my bearings and to gauge the length of the path traversed by the generations of economists since then. In other words, I shall attempt to outline the ethos of present-day economics, using Marshall's lifework as a foil. To sketch the characteristic spirit of present-day economics is a hazardous undertaking because, for one thing, the omission of a roll call of celebrities must needs do less than justice to individual authorities and to Marshall himself. The most that can be expected is that an ensemble in perpetual flux will be brought into focus and a snapshot obtained that will not deviate too much from reality.

Economics has covered a long distance since Marshall's death in 1924. Between his time and the present day, far more than twenty years seem to have elapsed. To characterize the intellectual interval that separates modern from Marshall's economics, one might say that the latter-day attitude towards his lifework recalls what Xenophon said of Sparta: "All admire Sparta, but all are averse from adopting their system."

In several of his public addresses, especially in the one entitled, "The Old Generation of Economists and the New" (1896/1897), Marshall ventured two predictions of which the one did not materialize while the other came true only too well to be pleased with. Said he: while the economists of the nineteenth century perfected qualitative analysis, the twentieth century will elaborate quantitative analysis. And further: henceforth economists will be informed with biological rather than mathematico-physical; that is, mechanical reasoning. In both respects modern economics has taken a different course.

With regard to the second prophecy it can be firmly asserted that economics has ceased to lean against or to borrow its methods from cognate fields of knowledge. Economics has come into its own stride, uses its own methods and terminology without scruples, is in no need of appearing in borrowed plumage, and is without fear of trespassing on

alien territory. The ill-remembered times of methodological wrangles in the narrow sense of this term, as to whether the historical method should have the precedence of the analytical or vice versa and whether deductive or inductive reasoning vindicates priority—those halcyon days are past, the implicit issues remote and laid up in the storehouse of the history of economic thought.

With reference to his belief that the instruments of qualitative analysis had been in his time refined to such extent that henceforth only quantitative verification would be left as the economists' main field, Marshall indeed showed great insight, but he did not foresee that his prediction would be fulfilled only too abundantly and that what started as healthy growth would tend to degenerate into exuberance. Quantitative measurement has indeed grown profusely. There is now the danger lest our Neo-Pythagoreans, fascinated by a sort of a mysticism of numbers, will kill genuine reasoning and leave us stranded with a slide rule and a table of logarithms as the only sources of cognition. In face of the idolatry of quantitative measurements indulged in by the economists of the abacus, one is justified in apprehension lest "fundamental brainwork," the wrestling with the very depths of any problem, abate. For however great the merits of the quantitative means of approach to economic and social problems may be, figures and proportions are the beginning, not the end, of reasoning. Numbers are not creative; they are useless to serve as an oracle, nor can they enlighten the path along which we move. They cannot allay the call of conscience nor spare the pains of discerning between right and wrong, nor can they supersede constructive imagination. Tabulations and curves are no substitute for values and ideals. The escape into arithmetic and geometry tends to deprive economics of its humanitarian foundation and the economist of character. To make economics a matter of cold calculation is a misdirected effort just as wrong as the mistake of the German warlords to make war a mere matter of arithmetic, or even worse, because they have embellished war with a lot of romantic illusions while modern economists pride themselves on having none. Superior mathematics and organization will not work out our salvation.

Marshall himself—it must be noted—was alive to the dangers incidental to an exuberant faith in numbers (compare his letters to Arthur Bowley) but his statements were open to the misunderstanding that the limits of the economically knowable had been reached in his time and that the frontiers of the universe of economic knowledge were closed. He did suggest or imply that the forces operative in the economic universe were known, that their functional interdependence was laid open and that what remained to be done was to bring quantitative analysis to bear upon the vast array of facts and thus make the incalculable quantifiable.

At present, however, we cannot help feeling that we have reached merely the outskirts of an immense field of still unincorporated knowledge, that the system-destroying facts outnumber by far those upon which existing systems are founded and that the systematization of all that which we do not know might yield us more for the true understanding of our world and of ourselves than the exact calculation of that which we pretend to know. It seems unlikely that we shall land safely in the millennium if only we were to succeed in refining our statistical and mathematical instrumentalities, or that we can mend our fences by patchwork or try to shun our responsibilities by shifting forward or backward those burdens that tax our moral and intellectual energies to the utmost. It appears that the age of mere quantitative measurement is drawing to a close in all fields of knowledge whose subject matter is human adventure. Too many new problems are come to a head calling for new solutions by unorthodox means. Humanization rather than mechanization of economics will help us along. It might be wondered if the faith in the magic of quantitative analysis in which modern economics is shaped is an effect or a cause of the thorough positivist outlook to which economics has pledged itself. For categorical positivism appears to have long since become the official philosophy or the creed of economics.

However this may be, nobody can fail to observe that contemporary economics speaks to us in a new tone reflecting a new ethos. The diction of present-day economics resounds with assertive self-confidence. Gone are the contemplative mood, the cautious skepticism, the slightly morose peevishness of former days. Austere stoicism has been replaced by serene epicureanism. Such saving qualifications as "tendency," "chance," "probability," "all other circumstances being equal"—all those formulas and charms used by scrupulous economists as backdoors to let the unforeseen slip in—came to be dropped. All this is equivalent to saying that modern economics is keyed for action. Present-day economics is inspired by a dynamic energy "that bids not sit, nor stand, but go." Intent on the maxim that the beginning of wisdom is action and the end of it more action, any statement implies, explicitly or implicitly, an imperative, a marching order, a clarion call for action. With momentous *élan vital,* modern economics brushes aside the traditional impediments, brakes, retardations, which lie athwart vigorous action. Former private virtues, such as thrift, came to be revealed as public vices; the accumulation of capital out of savings was declared as a misdirected effort of blockheads to be penalized by the tax authority. On high authority we were told that "finance is humbug" and were given to understand that depressions are avoidable instances of indolence, and even birth and death are likely to be considered a positive nuisance, if not gross misdemeanor.

Briefly, modern economics seems to be bent to the view that "reason becomes a shame, beneficence a worry." Modern economics is, in substance, an emphatic protest against all self-imposed shackles that prohibit activity. "Now or never!" is the watchword.

Refreshing as this spirit of wistful buoyancy is when interpreted as a token of youthfulness—a second youth, to be sure—and of the belief in the mircle-working efficacy of human will power and resourcefulness, one cannot with impunity take such a high tone of confidence all the time. One drawback is that modern economics is distinctly economics of the short-run and sometimes woefully short-run. It draws promises to pay which are expected to be honored at short notice, in the nick of time, as it were. With nonchalant disregard for long-term effects, concomitants and implications, modern stand-by economics, wedded as it is to the auspicious moment, kindles expectations which are projected into a near attainable future. As if it were to say, what does it avail to provide extensively for an uncertain future while the good things of life lie near at hand, ready to be plucked? Tomorrow we may be dead. Correspondingly, modern economics has lost faith in man and extolls measures. Many a modern economist impresses us with the idea that the economic future is merely a matter of manipulation and arrangement, a sort of collective bargaining extended over the entire area of social life. Man in the mass, for whose benefit all the arrangements are ostensibly devised, is likely to shrivel into a nonentity and to be conceived as an entry in a vast bookkeeping account. Man is like a mathematical symbol or a robot of which inanimate economic forces make havoc. The intellectual horizon of the economist has narrowed; his vista has become two-dimensional, as it were.

A consequence of this depersonalized attitude is that what modern economics has gained in precision, it has lost in vision. As long as economics took its bearings from the humanities, it had vision. Its vision might have been narrow and trite, but it was vision after all: the fullness of life, the good life, the many-sided individual, energetic enterprise, the national power state and other final objectives. Modern economics appears to have neither illusions nor articles of faith. The modern economist makes boast of his seeming freedom from prejudice and considers it a privilege that he has hardened his mind in the purgatory of what he terms scientific disenchantment. The question of what for, toward what ultimate goal, does not concern him. In his eagerness to catch up with instantaneous time and to be simultaneous with the events, the modern economist has changed in outlook and in working methods. The days of encyclopedic systems seem to be past for a long time to come. The ponderous tomes, the ripe fruits of seasoned reasoning, have been superseded by "tracts"—"Tracts for the Times" indeed

—conceived on the spur of the moment and designed to be ephemeral. The slow pontificating scholar has turned into a lordly pamphleteer calling for "a new positivism in the creative use of knowledge," who considers it his foremost task to lay down suggestions in the form of pamphlets. Is there not an imminent danger lest this preoccupation of the mind with instrumentalities with disregard of ends, this quickening of the process of cognition and the shortening of the period of intellectual incubation, will reveal itself a pathetic fallacy?

Marshall used to say that to qualify for an economist three great intellectual facilities are needed: perception (that is receptivity), imagination, and reason, "and most of all he needs imagination, to put him on the track of those causes of visible events which are remote or lie below the surface, and of those effects of visible causes which are remote or lie below the surface." Marshall never tired of reiterating that the economist's main reliance must be on diciplined imagination. Imagination—which is but another word for vision—is needed to kindle or develop the faculty of active sympathy, "and especially that rare sympathy which enables people to put themselves in the place, not only of their comrades, but also of other classes," and imagination is needed, too, in order that the economist "may develop his ideals," to which economic policies ought to be subservient. Modern economics seems to presume that it can dispense with imagination, either because it pins its faith on quantitative measurement or because it regards social ideals as a redundant luxury better to be left to the preachers. Correspondingly we notice a certain dilution of the faculty of discernment between values and a weakening of the critical faculty at large. As a writer of official papers, as the counsellor of governments, the economist projects himself into the role of the responsible statesman. He has an expedient to offer in any contingency, an antidote for any emergency which he disposes of with impressive persuasiveness. He pretends not only to know a hawk from a handsaw, but also the proper timing and dosing. Briefly, modern economics tends to become the knowledge of the art of governance, a powerful lubricant of the wheels of the administrative machinery, while governance tends to become ever more economic in substance. Some of those suggestions are conceived in a noble-minded impulse of generosity, and distributive justice—what Marshall called economic chivalry; others are postulates of economic reasonableness, but quite a few appear to be dictated by a spirit of vindictiveness and by the fear of the masses and the attendant desire to pay ransom to ward off a social revolution.

At any rate, government and economics have drawn close together and live in a real and, to large extent, in a personal union. While formerly the economist made his reputation by constructively criticiz-

ing governments, he is now hand and glove with them and has become the friend and patron of the governmental machinery whose severest critic he once was. Tact on all sides will be needed lest the intimate co-operation of the team ends in a loss of independence of either of the team workers. On the other hand, it is to be hoped that the joint effort will fructify both parts and enhance their respective sense of responsibility. Which part will benefit most from that mutual give-and-take in the long run, remains to be seen.

## II

It is not easy to refrain from conjecturing as to the reasons which may account for the new turn economics has taken in recent times. I do not presume that the problem can be solved satisfactorily. The growth of a particular field of knowledge is, the Comtian scheme notwithstanding, a puzzling and even a mysterious process. On the whole it appears that an individual scholar launches a new theory, thus giving the primary impulse; others take up the cue, and what began as a one-man heresy grows into a chorus of concurrent and discordant voices out of which the new doctrine with its intellectual and emotional fringe crystallizes.

Yet it might be a sensible undertaking to venture a surmise at random on a few of the so-called contributory "influences." One might point to the stimulus economic activism received as a concomitant of a universal tendency of recent times to institutionalize—and that is, to regulate and immobilize—everything, a tendency, too, which in the field of economics was strengthened by economic "institutionalism" with its implicit suggestion that the plasticity and malleability of the economic system knows of no limits and that what has grown slowly is liable to be redone and altered at will. Concurrently the state is invoked in all matters in which people feel or know that society will not act with desired promptness: the "there should be a law" attitude has become endemic.

To drive nearer home, one might recall, next, the fact that the relatively easy overcoming of the depression in Britain—apart from some stagnant pools—by taking counsel with and following the unorthodox suggestions of the economists has raised the prestige of the expert economist. Again, in this country, the New Deal policies have set in motion a vast array of brain waves which made havoc of inveterate habits of thought. Then there is, again in England, the admirable contribution made by economic analysis and constructive criticism towards the setting afloat of an effective economic administration for war purposes. In all these instances it might justly be wondered, however, if such success as was attained came about because the underlying theories were right

and impeccable or in spite of their being false or lopsided.

Under the impact of junctures which have confronted economic thought with novel situations and in which the economist has been put on his mettle, the lesson has been brought home that with "lucidity and daring"—foremost with daring—we can become masters of our economic destinies and that salvation lies not in economic asceticism and Micawberism but in the "prudent investment" of our resources and energies according to plan.

The most important change, however, which has shaped the outlook of modern economics, has occurred in the sphere of politics rather than in the economic field proper. It is the fact that the state itself has in the last few decades undergone a metamorphosis, and accordingly conceives of its functions in a new light. The modern state has renounced its traditional role of political schemer and plotter. The fact that we in these days witness the last convulsions of a few superpower states should not blind us to the recognition that the modern civilized state has abjured violence and all the paraphernalia of brutal power as favorite instruments of its daily routine. Might and prestige—the right of the stronger—are denied sanction. Conquests, imperialism, visible or invisible, the strife for exclusive spheres of influence, "dollar diplomacy," "king cotton," "the white man's burden"—all are superannuated. Our old "enemy, the state" has become a monster of virtue, an angelical institution, as it were, who craves to be the friend of all the world, with malice towards none. Leviathan is saturated or even surfeited. The modern state braces its energies for moral conquests, for gaining power by reputation rather than reputation by power. Accordingly, its scope is now the betterment of domestic conditions, maximization of social welfare, equitable distribution, the care for the underdog, economic security, the development of the national resources, etc. In proportion as the militant has given way to the humanitarian state, the economist moves in to the foreground and stands by to lend a helping hand by advising, prodding, and egging the government to ever larger ventures. It is evident, too, that the new scope has conferred on the state and its adjuncts and auxiliaries a new momentum, the scales have tipped over from the phantom "economic man" to the government, conceived of as the guardian and purveyor of popular mass-ideals. What used to be called "economic freedom" of the individual, that is, freedom of enterprise and individual initiative in matters economic, is at a heavy discount, while the state, released of the onus of power politics, concentrates on building up an effective, ramified administrative machinery, run as a government monopoly, an octopus with skilled experts as the arms—experts who, paid part in money and part in honor, grow an *ésprit de corps* of their own, while many a citizen remains only too

willing to charge the government with the management of his "ordinary business of life." To the growing humanization of the state corresponds an increasing collectivization and politicization of the individual. Yet far from disparaging the importance of the individual, modern economics has assigned to him a new dignity. No longer is he conceived as a robot in pursuit of his narrow personal self-interest. Rather is he expected to carry the noble responsibilities devolving upon a statesman whose actions and omissions are "affected with public interest." Thus under the incumbency of a new welfare clause, he is placed in the limelight of publicity and becomes a public personage subjected to new standards of accomplishment and proficiency. He cannot be let alone any longer nor is he permitted to act in splendid isolation. He is called upon, it is true, to surrender part of his economic sovereignty, and if he regards the demand too exacting, it must be remembered that an equal sacrifice on behalf of the public interest is postulated from the state itself. Is the regenerated "economic man" ready to grow into the new role assigned to him? This is one of the problems to be resolved in the future. No wonder that at present the borderline between the sphere of government and the precinct of business, between state and society, are effaced. So are the contrasts between capitalism, socialism, communism. Revolutionary criticism has grown meek. The shades between party lines are blurred. Political stalwarts are mock-heroic. Old-fashioned liberals and new-fangled communists are on speaking terms once more and the lamb and the lion lie down under the protective shade of a benevolent government without rubbing one another the wrong way. This conciliatory attitude would be a matter of pure joy if we could make sure that it was steeped in the spirit of genuine tolerance and deep-seated common convictions. But there are many symptoms indicating that it springs from general indifference to categorical values. Hatchets will easily be buried when the zones of serious conflicts are camouflaged by mutual indifference toward primary and ultimate objectives.

Thus from whichever angle we approach the problem, analytically or genetically, the bits and fragments arrange themselves into a kaleidoscopic picture: present-day economics, seen as the intellectual response to overwhelming challenges, is inspirited by a strong will for action under the auspices of a similarly-minded government, getting along in the twilight of dimly remembered values. While modern economics tends once more to wax political economy in search of remedies for recurrent shocks and dislocations, we should not let ourselves be deceived into the belief, however, that we have found an antidote to all our evils and conflagrations. Living as we do between two worlds, we observe that in the rear of every provisional solution a welter of new oppressive issues

looms large on the horizon. It is relatively easy to reach a consensus with regard to immediate objectives of policies such as to increase the national income, to diminish unemployment, to provide a tolerable maximum of economic security, to reduce improper inequalities in the distribution of the means of welfare and others. But the economist, inspired by the desire to do good and avoid evil, must open his mind to the dreary fact that social and economic ideals do not dwell together in blissful harmony; rather, they clash with one another, leaving the delicate task of finding a balance between conflicting elements. We shall have to be content with compromise solutions and this involves decisions as to the structure and scale of values. In the realm of values, however, the only valid currency is pitiless barter. The price to be paid for the attainment of one desirable objective is the compensatory sacrifice, wholly or partially, of another ideal which comes off second best. Real costs are alternate choices.

To mention but a few of the harassing problems: a new accommodation will have to be attained with regard to what we want to render unto Caesar and what we want to preserve for ourselves; and it would be preferable if the decision were made by us rather than for us. There is the further question of how much prosperity we stand ready to sacrifice for the sake of security. There is the conflict between free enterprise and collective organization, between stability and progress and many other problems for which orthodox economics provides hardly any guidance. And there is, lastly, the perennial discord as to whether seasoned thought—"which makes cowards of us all"—or ebullient action—"which makes us evil at heart"—could claim precedence in directing the conduct of our collective affairs and as to whether the economist is to be the detached spectator or whether he ought to plunge headlong into the melee.

If this outline has tolerably epitomized the ethos of contemporary economics, it should be possible or at least permissible to peer into the future and venture a guess what the economist will be like in the years to come. It must be understood, of course, that to describe a trend and hazard a prediction are not tantamount to laying down a canon or program. It is not suggested that present-day economics is the only imaginable or the most desirable type to be attained. It is conceivable that economics will take a different turn once more, but bearing this proviso in mind, we might do well to learn from what *is* what is *becoming*.

Most likely, then, the economist of the future will not be a regular college professor. He will be either a free-lance writer, working under heavy handicaps, or he will have to be looked up in one of the research institutions or in a government office. He will be a headstrong realist;

if he has any feelings he will hide them under the cloak of reticence. He will be of the cameralist type much more than of the liberal species. The reason of the state will be his directing principle and he will conceive of the state as the untiring benefactor of the community. He will probably have more intimate knowledge of realities than our former masters, but less character. He will have more versatility and fewer unswerving convictions. It might please him to play the cynic and he will not disdain speaking with his tongue in his cheek. He will be, alas, or affect to be, an adamantine pragmatist, until in a more remote future after having done his share in bringing our house in order, he might subside or find out that some other factor, a very new or a very old one, has become more momentous in shaping our lives than the impact of oppressive economic forces. Present-day economics in the civilized countries of the world impresses the observer with the semblance of a vast co-operative team which on the roaring loom of the times weaves the fabric of our economic, social, and political knowledge. An invisible hand appears to direct the efforts of a multitude of workers in many lands towards converging ends.

Identical problems are under discussion everywhere, issuing in more or less equivalent results. Yet it is highly desirable that originality assert itself over against the uniformity of reasoning and outlook. A place should be reserved—a place of honor indeed—for the lone-wolf economist who, not content with being a guardian of a treasure, is bent on launching new creative ideas to inspire us, who has got the stamina for being an innovator rather than an inheritor. Every imaginable opportunity should be opened to him; for his like has at all times been the leaven that has wrought authentic intellectual progress and prevented us from lapsing into comfortable dogmatism. We cannot afford to let the square-toe economist die out, for he will have to accomplish a significant function in the future. It stands to reason that when economics, after having completed the full circle of economic materialism, determinism, and positivism, will have run into a blind alley, it will devolve upon the nondescript, the nonconformist economist to impregnate and fructify the dried-up field with the spirit of critical idealism which experience has proved to be the medium in which long-range problems can best be dealt with.

# INTERRELATIONS BETWEEN MORAL AND ECONOMIC FACTORS IN THE POSTWAR WORLD

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Using elements of political and economic theory, I propose to discuss my topic essentially from a political angle. What I shall try to give, does not claim to be more than a reasoned opinion. A verdict of compelling scientific validity seems to me impossible where we have to deal with an unknown number of not exactly known variables changing over a not exactly determined span of future time in a not exactly known way.

Still it seems to me a rightful and proper preoccupation of our meeting to try to clarify our opinion and possibly to establish principles and directives to guide future action, bringing to bear on the discussion historical experience, common sense, and such elements of theoretical politics and economics as may seem appropriate to our task.

Interpreting my topic in the light of the apparent purpose of the entire program of our discussion for these days, I shall understand it to center on three questions. These are: First, which are the relative roles and functions of ethical forces and of economic forces in modern Western civilization? Second, in what state are both sets of forces likely to be when the current war is over? Third, in what way can they and their interactions be influenced so as to facilitate the restoration of a reasonably stable society and with it of economic recovery and prosperity?

Let me begin with a few rather general remarks stating certain basic assumptions of my paper and summarizing, thesis-wise, its main results.

In my topic, it has been assumed, and I accept the assumption, that there is such a thing as ethics as distinct from rational economic pursuit or, in other words, from economic prudence.

Ethical motive as against economic motive can be distinguished only if we acknowledge the reality of spiritual values, transcending material satisfaction; practical importance has the distinction only if we do not take a strictly deterministic stand but rather recognize the capacity and hence the responsibility of human beings to orient their action with more or less effect towards the realization of ideal values. Without the former assumption, ethics as distinct from prudence have no object; without the second they are an empty powerless dream.

Ethical tension and, what is equally important, an essential community of ideals seem necessary, not only for the maintenance of an orderly political society, but likewise for an orderly, effective economic

process, regardless of the nature of the economic system. Furthermore, there must not only be ideals and essential community of ideals, but there has to be compatibility between the prevalent set of social ideals and the motives and mechanisms of the economic system which is the material basis of the respective culture.

Thanks to an unusually favorable historical constellation, ethical tension and unity in ideals compatible and often even highly consonant with the prevailing form of a private business economy existed through most of the nineteenth century. Gradually, however, that ethical tension and unity in ideals, and consequently their controlling power over the political and economic social processes, has been progressively weakened, while at the same time antinomies developed between the organizational tendencies and social tendencies arising in modern industrialism and the traditional individualistic and personalistic value pattern of Western society.

The first World War marks the loss of rational control over the national and international social processes—a control which so far we have been unable lastingly to regain. To regain it is not so much a matter of mechanistic planning and governmental direction of the social-economic process as of the restoration of moral controls, of strong common ideals and convictions without which no rational control of the social process, and especially of its economic phase, is possible.

The highly dynamic nature of both the modern political and economic processes, and the inevitable shifting and blurring of habitual lines of demarcation between both spheres of social activity, will always invite ideological and political collectivism and despotism. In order to keep this tendency under control, an integrally liberal and humanitarian education has to strengthen everywhere in the leading groups of society—politicians, public administrators, business, and labor—the will to maintain and safeguard personalistic and humanistic values.

Now for my first question. The personalistic Western culture of the nineteenth century rested, as did Western culture and civilization in the preceding centuries, on a still strong belief in absolute values. The great majority of people in that society believed in those values which appeared to them to be self-evident and universally binding. The fact that some of these values were of predominantly Christian origin while others stemmed from Greek philosophy had not prevented their blending into a rather harmonious and consistent pattern of thought. Thus it did not make much difference whether men recognized the moral obligation from man to man because of a common filial relationship to God or because of the common human privilege of reason and free will and the universal human dignity derived therefrom. Equally it made no

difference whether the ideal of a peaceful social community was upheld on grounds of Christian doctrine or as a rational precondition for that human progress to higher standards of intellectual and ethical refinement and of comfort in which the optimistic followers of the "Religion of Progress" believed.

So long as such general ideas maintained their power, the specific ethical positions derived therefrom—such as those forbidding the arbitrary destruction of human life and limb and freedom, or those demanding truthfulness and honesty in human intercourse—were relatively easily defended and legally enforced. As the relaxation of Christian ardor not only resulted in indifference but also in tolerance, while much of the current secular philosophy, particularly in the Anglo-Saxon countries, was at least not systematically arraigned against the Christian faith, the struggles over differences in what are considered basic values which so often have proved fatal to society, were essentially absent. This is true in spite of a temporary flare-up of the dogmatical differences between the Catholic and Protestant Christian denominations which in some countries had minor political consequences.

In the nineteenth century, as always, not all values which guide human behavior are of an absolute nature—absolute in the sense of being derived from notions which in the eyes of their believers have supreme, absolute, and universal validity. There are the ethics belonging to and derived from specific institutional arrangements, which could have been arranged differently under the same fundamental principles. There is, for instance, monarchical loyalty versus republican virtue. There are also particularistic group ethics: love of country, of family, professional and class loyalties. They may not only differ but even clash between different groups. Such clashes occurred in the nineteenth century, but the restraining and compelling power derived from absolute ideals was still strong enough to keep these clashes within the bounds compatible with an orderly social process.

Especially, the degeneration of early liberal patriotism, based on humanitarian ideals, into nationalism had not yet taken place. Nationalism with its exclusive and often purely materialistic tenets only prevailed after the idealistic faith in a higher order and in human progress as the common destiny of man had been lost.

There remained finally a strong habitual basis for the maintenance of a personalistic culture in the sphere where human behavior rests upon a quasi-automatic element of folkway and habit without much conscious ethical connotation. The importance of folkways, mores, and individual habits in the maintenance of a certain pattern of social ethics is of course very great. A relatively static society on this score at least maintains its traditional ethics more easily than a rapidly changing one

where folkways, mores, and habits are constantly broken and have no time to resettle in new grooves.

Incidentally, those who want to peg the weakened ethical structure of modern society by trying to restore a similitude of medieval society, where status rules, seem to me to overlook the inevitable dynamic implications and tendencies of scientific industrialism—tendencies which show no sign of having spent themselves.

There is hardly room for doubt, however, that the nineteenth century continued to draw social discipline and cohesion from still surviving folkways, mores, and habit patterns of a fairly well-integrated society of the past, particularly of a well-integrated rural society of the past. At the same time, the vast horizons newly opened up for material and, as was too easily assumed, also for human progress, stirred not not only the greed of the lowly but also the noble enthusiasms of the outstanding and the distinguished ones in all walks of life, including economic life. Yet such resurgence of idealistic energies may bog down in confusion under the impact of too rapid an economic development and change, after the traditional spiritual reserves behind it are exhausted. This seems to have happened in Western civilization in the late nineteenth and early twentieth centuries. This exhaustion and confusion is partly due to the overwhelming impact of a massively mechanistic and materialistic civilization, partly to a lessened understanding of and failing moral adherence to the basic verities and values of our civilization by leaders and followers.

The vogue of the natural science in popular philosophy unwittingly contributed to this. Individuals, groups, schools, and parties began to experiment in thought, word, and action with our civilization, as if that could be done with the same impunity and overwhelming profit with which scientific experts wrest the secrets of nature from it and the engineer applies them. But while nature can only be partly explored but not otherwise affected by science and while technology could only slightly abuse it occasionally, things are entirely different with regard to the effect of social experimentation on society. A civilization is a man-made thing, which man can easily destroy by reckless and inconsistent handling. Only a few at any time fully understand the logic of a civilization and can apply it consistently in political and economic action. They can do so only when common moral conviction of people in general, compatible with that logic, sustains their authority and gives them loyal following with the masses, and provides control of conflicting and destructive antisocial tendencies of individuals and groups. As soon as too much and too irresponsible social discussion and experimentation has confused and destroyed the common moral ties binding the members of a civilization, a civilization becomes unman-

ageable except by sheer force and that is exactly what has happened to Western civilization in the last decades.

The fact that at the same time it came into ever closer and more reciprocal contact with foreign cultures did not contribute to make things easier.

When confused thinking and failing or divergent creeds coincide with a growing need for consistent political controls over growingly complex economic systems, the danger of violent short cuts in the form of war and plebiscitarian despotism founded on demagoguery and mass hypnosis is at hand.

Ethics are important to the economic system in two ways: indirectly in as much as they support and maintain the political and administrative organization of society and give strength to its legal arm; directly by enlivening and controlling economic activities proper. While this is true in all conceivable types of society, it is particularly obvious for the liberal society of the nineteenth century where political and economic activities are institutionally set apart and, therefore, can also be easily separated in the minds of men, their actual interdependence notwithstanding. Politically, as men like Lorenz v. Stein saw early in the nineteenth century, the traditional legitimacy of monarchies was highly advantageous to the prevailing capitalistic system after absolutism in constitutional monarchies had struck a compromise with the bourgeois classes. The constitutional monarchies protected the bourgeoisie against violence from the fourth estate while the professional, well-trained, and disciplined bureaucracies and judiciary bodies, which the dynastic states had developed, were well suited indeed for the reliable administration of the complex system of property laws, contract laws, bankruptcy laws, and for the monetary and fiscal administration consonant with the needs of a capitalistic society. While the bourgeoisie accepted in the constitutional compromise the political predominance of the monarchy and its administration, particularly in international matters, it got in turn the parliamentary control over the fiscal processes and the constitutional guaranties of personal freedom and independence and of private property vital to its interest. At the same time the authority of the church—sometimes more than was warranted by the supreme interest of religion—backed up the existing combination of traditional political powers and new economic powers, while lack of class consciousness, of organization and leadership kept the nonproprietary classes at bay for the time being.

In countries where the bourgeois revolution against feudalism and dynastic rule was fully successful, the rationalistic assumption which regarded a democratic republic and possibly a parliamentry government as the only forms of government consonant with the self-evident logic

of society such as nature had willed it, had given a strong sort of new legitimacy and a great emotional authority to the governments of that type. They were of course highly consonant with the requirements of a capitalistic society as long as the proprietor's interests entirely prevailed in the democratic parliaments and in the choice of presidents and cabinets governing those countries, which except for episodes was nearly universally true throughout the nineteenth century.

When the time came to fuse the individual national economic systems into a world-wide economy, the cultural, military, political, and economic prevalence of the Western powers made this possible. Free ground for political and economic conquest abroad as well as essential identity in thought pattern and ideals of the leading classes and the unchallenged prestige and leadership of England made this world-wide effort successful. In spite of the notion of full national sovereignty, a sufficient degree of monetary co-operation—culminating in the world-wide gold standard system and in the international credit management supporting it, essential international free trade, and sufficiently uniform international private and commercial law—established a truly organized international economic society.

As for the ethical sanctions directly controlling and maintaining the competitive private business system itself, I mention only the affinity of puritan, and especially of late puritan, ideals and ways of life with the requirements of an economic system demanding an energetic, self-disciplined endeavor, sobriety, and thrift, which the studies of Max Weber, Tawney, and others have brought to light. I mention the importance of the Christian doctrine of humility, forbearance, and charity in mitigating social conflicts. I mention the Deistic ethical doctrine of the invisible hand, which put the halo of a divine institution on the self-regulating competitive system, until the later rationalistic and hedonistic utilitarianism simply forgot about the miracle of this supposed self-regulation and extolled the mechanical virtues of the competitive mechanism, with little thought of the peculiar complex and in fact highly precarious historical circumstances, institutions, and social forces behind it.

In the period of capitalistic spacial expansion in the later nineteenth and earlier twentieth century, Christian missionary zeal on the one hand, and the idea of progress and of inevitable Western leadership in the process of civilizing the world on the other, gave sanctions to political and economic imperialism, regardless of possible crass contrasts between actual performance and pretense.

In fact, since the forties of the nineteenth century individualistic economic notions of the Western nations and the corresponding political value pattern had sufficiently settled in the folkways and mores of the

leading classes and their following to seem rather self-evident and beyond philosophical argument or critical scrutiny of any kind. Such criticisms were considered not respectable.

This stability of inertia in a spiritually weakened culture might have lasted much longer had it not been for the catastrophe of 1914 in the international political system—a catastrophe which can be largely attributed to the clash of the political master idea of the nineteenth century (that of national unity and independence) with a political map of Europe of older historical vintage determined by dynastic conquests and hereditary acquisitions.

That this political catastrophe had such lasting and well-nigh incurable effects on Western civilization must be attributed, however, to the fact that it hit upon a social system which was already undermined by the slow but certain operation of those features of modern scientism and of industrialism which were inimical to the traditional liberal pattern of Western civilization.

While to my mind science is from a logical standpoint perfectly compatible with religion and a spiritualistic or idealistic philosophy, it has actually produced a mental climate among the educated—and much more so among the half-educated—which is greatly adverse to the maintenance of a vital faith in transcendental values. Positivism, while of course necessary and entirely legitimate as a method of science, has been made, I am inclined to feel, rather rashly, into a popular philosophy of life and behind it there has trailed a highly materialistic pragmatic philosophy. Positivism as a popular philosophy has taken hold of much of our legal thinking and practice. This resulted, particularly in Germany and Austria, in schools of the academic legal profession claiming equal validity for anything that has come out of the established formalized processes of statute-making and jurisdiction and is enforced, regardless of its ethical qualifications and the degree of its consistency within an established framework of ethics. On the other hand, the pragmatical and at the same time materialistic philosophy has influenced legal thinking to the extent that law has been considered merely as the tool of the mighty in pursuing their subjective interests without more sanction than a constellation of might behind it. It is altogether too obvious that positivism and pragmatism thus applied by the guardians of social order are bound to do spade work for the pragmatists of despotism.

It is not surprising that the scientist is so often loath to recognize these dangers of the viewpoint of his profession when carried too far. In the first place, thinking in terms of what sometimes rather loosely are called "facts" and in logic derivations from factual observation, he is naturally inclined to confound the world of his own thinking and

professional pursuit with the entirety of human existence. Yet, however irrelevant, even nonexistent, anything not based on ascertained facts may seem to him, with his rigorous self-discipline and reverence for truth, he is in fact still morally upheld by spiritual and truly ethical motives. In the average man, however, who does not acquire a scholarly scientific attitude but only a purely emotional pride and conceit from the observation of modern science, it produces (as Gaetano Mosca observed and Taine, among others, observed sometime before him), cynical scoffers rather than sceptical sages. After having rejected as outmoded noble ideals which create and maintain civilized life, the average man, as Mosca observed, is very apt to fall with his empty soul easy prey to all sorts of superstitions and to the mind quackery of the pseudo-scientific and the political charlatan and demagogue. In losing sight of the ideals which have hitherto controlled creative social endeavor, he also loses the sense of and the reverence for human superiority with the effect, which Ortéga has so well shown, that it becomes progressively more difficult to maintain the authority of the true and born leaders in society who are swept away by the well-chosen representatives of mediocrity.

Industrialism—that is, applied science—has also not only enriched humanity and freed it from much drudgery but at the same time, very much against original expectations, it has weakened the love of freedom, as it established new, apparently inescapable, dependences. Materialism has been fostered by the high pressure salesmanship for the disposal of the utilities and gadgets produced in imperfect competition, and settled styles and folkways have been broken. The remoteness of the tool operator from economic control and economic responsibility and the inevitable hierarchical and regimented characteristics of modern industrial organization have not only divided society anew into commanding and subservient classes but also have jeopardized the personal spirit of workmanship and have favored a deterministic attitude and philosophy with the masses. The spasmodic operation of the system with its frequent layoffs has added a feeling of helpless insecurity to the bitterness arising with the working masses from the sometimes arbitrarily used superior power of managers and capitalists. Among the latter, management and ownership have been separated. Economic power and big income have been largely dissevered from economic risk and sometimes from creative function in a way which makes it hard to defend the notion of individual or family property on this level of corporate business organization. Finally, the whole system, on the business side and on the labor side, as we all know, has developed rigidities and tendencies toward monopolization which not only have tended to hamper its steady and full operation but again make the

maintenance of the notion of strictly private business difficult, as the ideas of private business and the neutral state require effective though not necessarily perfect competition as a logical complement.

While monopolies and near monopolies hampered smooth and timely competitive economic adjustments, they helped to create those manifold lobbies and pressure groups and political organizations of individual and group interests which became so many states within the state and threatened not only the integrity and consistency of national policies, but even of international policies, particularly in the field of foreign trade regulation.

According to the view of many it is only due to the rapid intensive and extensive (or spacial) growth of industrial capitalism until 1914 that it did not succumb to all these difficulties.

With regard to the conditions following this war—and this brings up my second question—they are still very much hidden from our eyes. One thing at least seems certain; namely, that victory means no more than another opportunity to build a new world with strong ethical foundations and with a political and economic system in sufficient mutual harmony. What amount of ethical force and consistency in action we will be able to muster for the work of reconstruction and maintenance of civilized life nobody yet knows. Relapse into chaos is possible; so is another turn towards authoritarian collectivism, abandoning in the act the essence of Western tradition.

As we do not want either, it is for us to explore the possibilities and ways of restoring and maintaining an individualistic or rather personalistic civilization. This will be most difficult at best. We can be fairly certain not only to be confronted with the impact of the mass mind warped by the propaganda machines of despotic rulers but, in either camp of the present war, with much of that intransigent exclusive nationalism which has harassed all rational political and economical alignments already so much in the near past, and also with a considerable amount of racial and class bigotry.

In the light of current observation it seems likely that in the immediate postwar period there will be, with the great Western powers at least, little tendency and appetite for far-reaching changes in social organization and in the economic system. In spite of a temporary individualistic reaction in this country, however, I believe one can count on a very definite desire to maintain a considerable degree of popular influence on government and thereby on the operation of the social machinery for production and distribution of utilities. There will be, in other words, a popular desire, influential in political life, for an economy where private and governmental influence will blend in a more active partnership than in the period before 1932. This desire

will be effective, as it is bolstered by objective requirements of the situation. The present reaction in this country against what is felt to be too much government interference, to my mind, will influence but not eliminate that trend which seems to be more readily accepted as inevitable with our European war partners outside of Russia, and also in many South American countries and with the British Dominions.

Internationally we fortunately have good reason to hope that the world to come, while it certainly will not begin with that ethical, political, and economic community of all nations which the League of Nations too readily assumed in establishing its system of international and intergovernmental democratic procedure, at least will start with the fairly solid working alignments and co-operation of the big world powers in Europe, Asia, and America. This alignment to my mind offers promise of duration only if reasonably soon implemented into a true world organization, and especially provided with a definite frame for the co-ordination of the political forces and aspirations of continental Europe. It will have to last long enough to give the opportunity for filling it with the institutional substance and the soul of a true world community of interests and aspirations. The chances of success on these lines depend as much on the moral self-control and restraint of the big powers as on the efficiency with which the essence of civilized life and aspirations is restored wherever it had been undermined and destroyed in the past decades. Success is facilitated by the fact that none of the big powers, aside from possible mutual fear, which has to be eliminated, has any material reason to seek further aggrandizement.

Given the very close neighborhood into which modern technique has thrown all the peoples of the earth, they have only the choice of living peacefully and co-operatively together or of fighting it out for the spoils of predominance. In the latter case the impact of war needs on economic life is to my mind absolutely certain to destroy everywhere any worth-while amount of individual independence and personal, self-determined life and work, while the virtues germane to regimented and mechanized war will establish ethical standards which cannot be reconciled to what we are wont to call culture.

Modern war makes such violent demands on the individual, against his normal and natural tendencies, that in the long run he cannot be held to it without the strong political magic of propaganda and possibly not without intimidation and outright force. Therefore, survival of our free civilization depends on international durable adjustments.

With regard to economic conditions following this war, we may take for granted a further rapid progress of science and mechanized large-scale production, as the war will bequeath a host of incipient unex-

ploited technical possibilities for industrial use. We will see the extension of industrial methods to the field of agriculture. This will further involve farming into the financial and marketing problems characteristic of large-scale industry, will increase the similarity of monetary and credit operation in both economic fields and the tendency towards monopolization of markets with or without government aid and control.

We may assume for the future a very considerable share of government in the economic process both as a regulator of and as a participant in business. For the immediate postwar period this is obvious. For one thing, if we want to avoid sharp inflation with the resulting ethical as well as material confusion, it may be necessary to continue some controls over demand and prices until the gradual release of dammed up monetary savings from the war meets with an adequate supply of goods for civilian use. This is, however, a field in which not all need to be left to government initiative. Private oligopolistic and monopolistic business through its sales policy can do much to channel and to time future civilian investment and spending following this war.

For the more remote future, regardless of to what extent one has faith in the theories claiming a tendency towards permanent underconsumption and underinvestment and economic policies of cumulative deficit spending derived therefrom, one must expect considerable government activity. There will be regulation of mass incomes and mass savings through schemes somewhat like the Beveridge Plan. One may count on great public activity and government participation in town planning and building as well as in rural settlement. Armament likewise is likely to remain a field of vast public investment and expenditure. There will be the necessity of checking and breaking monopolistic retrenchments of business and labor.

With the sector of socialized investment and socialized consumption and the field of public controls thus enlarged, the maintenance of an essentially liberal, that is, personalistic, society will continue to encounter great obstacles and problems.

In meeting these problems—to come to my third question—the first and most obvious ethical desideratum is the strengthening of the moral foundations of world community and co-operation. We have to rebuild them in a world which through decades has been used to competitive and aggressive nationalism and to aggressive international economic policies, a world still torn by racial and social strife.

We cannot commandeer religion and transcendental philosophy anymore than can we commandeer the emergence of a true world philosophy, but we can aid positive growth and repress negative tendencies; in other words, we can attend to this field just as the gardener attends to the vegetative growth which basically nature provides for him. In

doing so, we are favored by the fact that the organized attack on the remaining heritage of religion and transcendental philosophy and humanitarian and individualistic morals has produced a considerable rally of all the various religions and denominations which have a monotheistic concept and the idea of human brotherhood in common.

In our education, while retaining its humane characteristics, we ought to abandon all too soft and easy ways so long in vogue. The millennial experience of all efficient elites shows the importance of firmly insisting on high standards of performance and behavior in building reliable characters imbued with a sense of social responsibility. This is true in all phases of youth and adult education.

From schoolbook and textbook writing to newspaper and radio, magazine and book, we have to revive, without regimentation, our sense of educational responsibility. In this connection we face, for instance, the task of weeding out the seeds of narrow nationalism and group bigotry of all kinds. To repress is not enough, however. I would like to put particular stress upon bringing the human mind and particularly the youthful mind in far more frequent contact with true human greatness. Fortunately, the war has put the Bible into millions of hands which had never handled it. This is not enough. The Spirit expresses itself in thousands of other great books and in works of art which our system of education tends far too much to keep away from the student, while feeding him with uninspired eclectic textbook matter meted out by frequently uninspired teaching. It is not only a matter of good book shelves to which the student in school and college should be led, but of good, inexpensive, possibly publicly subsidized, classical editions to be fed into the home libraries. It is a matter, as I see it, of considerable reorganization in our whole system of school and college education. Fully aware that I may stir up a hornet's nest of interest and fixed viewpoints here, I think that it is time to bring the liberal arts, handled in a truly humanistic spirit, back to the fore again, not in order to put positivistic scientific pursuit out, but to integrate both in a truly philosophical higher education. The time has come when we must recognize the integrating function of the liberal arts. There is no valid reason, as I see it, from the viewpoint of positive science, to fight against such a tendency. A universally applied positivism takes too much for granted in social life. Logic and experience alike seem to show that positivism alone cannot integrate society, whereas it bears its best fruits only in a society which is integrated. But all of this, let it be understood, is not a matter of dusting off and passively admiring museum pieces. It is a matter of revitalizing our traditions by integrating them into moving life, by working on them with modern minds. To be afraid of our heritage often betrays a lack of self-confidence and

creative powers. It is remarkable and most gratifying that collectivist Russia does not seem to be afraid of personalistic art, provided it is great art.

The future continuous industrialization of our society posits not only a dilemma but a great opportunity. We can make this opportunity by drawing the logical consequences of our mastery of the industrial arts in town-planning, in relocation of industries, and in the reshaping and relocation of agriculture. We can do so by systematically co-ordinating backward and advanced economic countries, not on a plane of exploiting capitalistic and industrial countries versus exploited primitive raw material producing and agricultural countries, but on a plane of rational division of labor from all fields and levels of production.

The gradual achievement of all this to my mind is not so much a question of technical knowledge and know-how as of co-operation in mutual confidence and common purpose between various national, racial, and social groups.

Industrialism in its mature form, outside of abnormal war emergencies, has produced and will continue to produce one thing above all: more human leisure outside of factory and office hours. This enlarged holiday is the great opportunity of a future liberal society. We must not regiment it and must also not leave the individual in his holiday defenselessly exposed to purely commercially inspired inducements to wasteful spending and senseless and possibly degrading amusements. This can be achieved in the first place by youth education which prepares the future adult not only for his future work but also for a sensible and cultured use of his future holiday and for a way of spending that makes sense from the viewpoint of cultured life. It is not for private business to educate the consumer, but for the educated consumer to demand the right things from business. Adult education in this respect is just as important, if not more so, as is youth education. Here again we should educate for something, rather than to put up a lot of *verboten* signs. The promise of the future for the common man is the good life, not only with reasonable material security and comfort, but with individual and group-wise pursuit of such religious, intellectual, esthetic, political, and civic interests, as have been too often and too long considered the exclusive privilege, and also the class badge, of the upper classes.

England, as Sir William Beveridge reported, has discovered a great longing and hope for this in her people, and is setting out in a comprehensive way to afford educational and other instrumentalities and public guidance, in order to implement that desire. In addition, fostering of pride in wholesome practical personal achievements, such as the establishment of an individual home and utility garden or small farm,

in which the family and—this is important—the family *jointly,* can fruitfully invest some of their holiday, is a way to build not only character but at the same time economic independence and security. Since we have to start from a competitive pattern of society, we can stimulate a competitive interest in artistic and esthetical achievements and refinement as well as in practical homework. While we want to steer clear from government dictation and regimentation of the holiday, it still remains a governmental obligation to provide choice of wholesome food for the mind, just as much as it is a recognized governmental obligation to secure sanitary drink and food for the body. There always will be, particularly in the field of canned music and the theater, a considerable amount of activity with purely or essentially commercial orientation. To counteract this a far greater amount of institutions held to higher standards are necessary than we now possess.

If we can rebuild in this way individual life which is more than satisfaction of material individual appetite, if we can depend on a vital home and family life, if we can give people more common ethical and cultural goals, we will be able to defend and maintain integral liberalism in our political processes and will win thereby a political orientation which makes at all possible the immensely difficult task of controlling the economic process without destroying private responsibility and initiative.

This problem can be solved only in a society in which the main partners in this precarious blend of government initiative and business initiative are jointly of a mind to keep it compatible with the tenets of a liberal society. It is very interesting to note that the Scandinavian economists and political scientists, who usually are more skeptical and modest about their achievements in controlled economy than their foreign admirers, often stress this point very much, stressing not only the relatively favorable economic conditions of their experiments but also the sober, law-abiding, intelligent, and realistic public opinion of their countries, the relative absence of sharp class conflict, and the basic individualism which the social democrats and trade unions share with the bourgeoisie.

We ought to be aware that we always, also in the nineteenth century, had a partnership between government and private business but a partnership where the government operated essentially in its more narrowly limited sector in a rather conservative, relatively static way, whereas dynamic evolution was essentially left to private initiative. We have now largely the reverse of that condition. It seems to me that in certain fields, particularly the monetary and credit field, after the first reconstruction period we will have to return to more conservatism on the government side and re-establish more stable conditions for the

actual content of private property which is largely determined by monetary conditions. Without this the spirit of self-reliance may not survive and the temptation may be too great for private pressure groups to seek fortune for their members, not so much through their high performance, but through the manipulation of the levers of public monetary and credit policy in their favor and to the detriment of both orderly government and economic equilibrium.

In general we will need a businessman who has understood that private business, even when in a more or less monopolistic position, can survive as such only when it continues to bring the fruits of technological progress quickly to the consumer, either in terms of better utilities supplied or of lower prices or of both. We need labor leaders and a labor following that have learned to understand that labor can expect from a capitalistic business system lasting employment at good terms only when it recognizes the structural necessities of this system with regard to profitable operation and sufficient capital accumulation and absence of arbitrary social disturbance. Whether such an attitude of responsible co-operation can be established directly between the parties or under the auspices of a public authority like the Australian Commonwealth Court of Arbitration may depend on individual conditions in various countries.

Last but not least, the guardian state which combines public control over a highly concentrated mechanized economy with the aspiration to the maintenance of a free personal life of its citizens can only survive if it has a civil service which is disciplined and devoted to make this possible. It is illusionary to expect that there will be an essential reduction of bureaucratic activities in a more and more technological and complex pattern of social life, where the expert of public administration cannot be missed. What is possible and necessary, however, is to develop a bureaucracy which clearly separates itself from current political conflicts and ambitions, considering itself essentially the servant and disciplined tool of the policies established by the political department of the government and being imbued with a truly liberal and humanitarian spirit. That England has been able to weather since the thirties a very high degree of taxes, public expenditures, public debt, and government controls and still to emerge with a prevailing will to return to a personalistic type of life and economy with much private management, is partially due to the fact that England has had time to develop a mature civil service meeting that description and meeting with the confidence of the leaders of business, of the leaders of politics, and of the leaders of labor, most of whom share the same educational background with the civil servants. They have not only a bread in common, over the sharing of which they may squabble,

but have their love for a culture and its values in common which they realize can only be upheld by their joint effort. In spite of the high standards of personal integrity in our bureaucracy, a similar achievement in this country is obviously more difficult, but partly so only because we have been confronted later with the necessity for it, are less experienced, and have more to learn. On the other hand, we still have more leeway for error.

Success in all this may in part depend on some rearrangements in our constitutional, parliamentary, and administrative systems and processes. This topic, however, while pertinent to my theme, defies generalizing short discussion.

Finally, so much seems obvious: Community of higher purpose between different classes and groups helps to solve national political and economic problems. Community of higher purpose between nations likewise helps to solve international political and economic problems. Each successful solution of national economic and cultural problems through a self-disciplined voluntary effort makes international success more likely, as the unity and firmness of purpose which is required between nations in order jointly to withstand the temptations to war and despotism and in order to establish sufficiently stable and trustworthy monetary and legal foundations for international investment and trade, depends on the internal stability of the partners. On the other hand, a flourishing and expanding international trade in a pacified world in many cases is a primary condition for national economic, social, and cultural rehabilitation. This is especially true for the hapless nations of continental Europe, west of Russia, who may not always be able to rise by themselves from the ruins of their spiritual and material civilization, but may need outside help. While tolerant and respectful of national desires compatible with a free and decent community of nations, such help should be applied in a steady way, which can only result from essential unity of purpose between the still integrated world powers around them.

# ETHICS IN THE STUDY OF DEMOCRATIC POLITICS

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It is one of the significant facts of our time that we are deeply concerned with the ethics of the democracy we seek to defend. Are we a generation with a guilty conscience created by the observation of the ruins of order, regimes, and economies? Are we trying to justify ourselves before the bar of reason? Or, might we say that this concern for values in political life shows a determination that we must do a better job when we have another chance to fashion history with intelligence?

What I shall have to say will be essentially a plea on behalf of the conservative moral tradition of the West. From the days of the Greeks to our own we have recognized in our better moments that we must work for the realization of justice in society. We have recognized that whatever may be the form of government, it is legitimate because it sustains in some degree political justice. When we speak on these subjects, we are, at the moment, both very ambitious and very humble. We are ambitious because we would like to say what justice is; we are humble because we recognize a standard or measure of ourselves that is beyond us. I recall Montesquieu was once said to have remarked that he knew a woman who could walk very well, but when anyone looked at her she became self-conscious and always began to limp. This, I fear, must be my fate on this occasion, for what we say on this program is subjected to pretty close scrutiny. At our best we are still a little lame.

Democratic ends and values is the central theme of this meeting. For the support of democracy today we must accept principles, because we reject the experience of a large part of the social world. We cannot rely on practice to defend democracy; we cannot justify ourselves by our success. Slowly but surely, and I think correctly, we are becoming less the pragmatist and more the doctrinaire. We are less casual about ends, and we must be more rigid in our attitude toward means. If we would be democrats, we must recognize that legitimate ends are to be attained by legitimate means. We speak from the valley of historic failure, not from the confidence born of past success.

At the middle of the last century most serious thinkers were sure of progress. When Lecky wrote less than a hundred years ago on rationalism, the future was bright. Superstition had all but been banished; science everywhere shed its energizing light; peace was coming, since industrial civilization implied and assured the permanent maintenance of peace. Democracy, liberty, nationalism, and international co-operation had arrived to stay. And at the close of the last century E. L. Godkin could say that there would never again be another man on

horseback to upset the progressive march of mankind. True, there were voices which spoke of pessimism in a contingent way. Henry George told us that unless we solved the problem of land monopoly we would go the way of other great civilizations. And the many voices of socialism insisted that doom was at hand unless the whole economy was reshaped. In general, however, it was not respectable to pay any attention to those who decried the achievements of what was truly a great century in the history of material human progress.

Now, in a twentieth century that is probably more bloody than any century in the past, we realize that something was wrong with the picture drawn by the optimistic liberals of a few short generations ago. Well, what was wrong? Why did the prophets of the nineteenth century fail so surely in their prophecy? Incidentally, they considered themselves highly moral, though admittedly they were secular in tone and sometimes anticlerical. If we look back upon these thinkers in general, certain defects may be readily noted. Many of the prophets of progress were little concerned with the source and importance of the moral dignity of man. Today we can see that the possibility of totalitarian thought is always present if the human being is not regarded as having an inherent moral dignity which political regimes must respect. Also, many nineteenth century thinkers failed to apply their principles with any depth to the existing historical situation in which they lived. Perhaps we should not blame them too much for this, because our own situation presents almost insuperable difficulties. There are, it is said, two hundred and six plans for the postwar world, and the authors of each believe they understand the future better than any thinker of the nineteenth century understood the twentieth.

The theory of democratic progress thus was uncertain in its metaphysics and it thereby failed to develop its conception of the source and nature of moral values; but it also tended to substitute for historical realism a philosophy of history that began and ended in the notion of scientific and secular progress. In the present day, so resolute a democrat as Reinhold Niebuhr has insisted that in history men face frustration, not because of ignorance as the last century said, but because of the selfish and self-interested nature of man. One might say, indeed, that a philosophy of history relies on factors outside of the choice of men; that is, factors that are objective as to the human will. In the nineteenth century progress was of this nature, since man was destined to make progress; it was, as Kant might say, a rational necessity which none could evade. May we cite also the example of the near-destitute Neapolitan Giambattista Vico who dreamed of a rational chronology that men must live whether they would or no? Or might we remember briefly Hegel's belief in the inevitable triumph of reason—

a triumph which he indeed saw shining between the sordid details of the Germanic world of his day? Then as now the essential conditions of moral living were violated, but because of the contrast today between the moral tradition of the West and those who would reject reason, it is possible to see a little more clearly.

Reflection on many details that may not be introduced into this discussion has suggested to me that as the eighteenth and the nineteenth centuries succeeded in the attack on theology, they also moved forward to attack morality itself. This latter attack was plausible only because of faith in progress. The falsification of progress, as in the present bloody period, suggests immediately that the attack was too bold, and fraught with consequences that many an ancient writer saw or experienced. Let us substitute for the philosophy of history the principle of history as an end-means relationship. The deterministic, objective and nonvolitional aspects of the philosophy of history can thus be rejected for a principle in which men may choose their ends, and the means which may be used through labor in history to attain these ends. Social history as ends and means in relation does not give us the right to sit idly by while the goals for which man lives are realized by an inevitable social process. Nor should we assume there is no frustration in history, for there must be degrees in which ends can be realized. There are conditions under which the democratic goals we defend must be attained.

The comments I have made on democratic theory in the nineteenth century should not be misunderstood. No one in his right mind is opposed to science, but science has changed greatly since the middle of the last century, and scientists are perhaps more cautious than they were. When we argue that there must be in democracy a reasonable defense of goals as we are able to state them and believe them, we face squarely another question. What about the naturalistic explanations of man, such as psychology and the imposing edifice which bears the name of Freud upon its portal? What about the facts of economics which, we have been told, govern us willy-nilly? Shall we say that technology and its managerial revolution shall be master in our house? Shall we say that the recurrence of war is almost as fixed as the cycle of the stars? Shall we, as democrats, describe merely what is happening in a punch-drunk world? Long ago Lord Acton pointed out that philosophies or interpretations of history have clustered around many startling ideas. We do not need to reject in the interest of ends or purposes any data obtained by science; but we do need to accept them as conditions under which the realization of goals must take place. We must likewise recognize that "value-free" discussion is essential in the development of science.

Thus we may say that the psychological interpretations of human

behavior involve most closely the question of values. We have all become amateur psychological analysts. But the amateur displays on a large scale what may be present on a small scale in the mind of the scientist. We have tried to by-pass the validity of ends or goals. A goal or a value, or even virtue, becomes simply an aspect of psychological investigation. Now the war and the crisis of civilization have brought us back sharply to the necessity of going beyond mere description; we must inquire by reason whether there are valid purposes or ends toward which we must labor. We may admit the conditioning factors as they arise, but to set limits to realization is not in itself to deny that an end or purpose may be true or valid. It may suggest even that a reasonable morality may set limits to and govern the use of science. We do not permit lunatics to possess dynamite, and we propose after this war to limit the utilization of science by aggressors. But we will do this in the name of purposes which we deem to be reasonable and valid.

Now democracy, I take it, is a form of government in which the masses of the people somehow participate in the work of government. It is an approach to that deep paradox of politics—the problem of self-government. We may admit that all legitimate governments rest finally on the consent of the governed, and this may include almost any form of government except tyranny or despotism. We cannot conceive of a people consenting to such governments in the first place. The devices of democratic government have evolved slowly through a long history, and we are never quite sure of the structural point which divides democracy from other systems. But as a legitimate form of government, democracy has a responsibility to accept the principles of justice. We do not believe that any democracy can ignore the rights of individuals who compose society. Democracy does not stand for the principle that "what the public wants" is always the test of right, though it certainly must be one basis of interpreting social needs at any given time. What we believe is that democracy can, and that democracy must, assume a responsibility greater than other regimes for the justice of its action. In other words, democracy must have a deeper and truer philosophical sense if it is to be preferred to other regimes. Since democratic peoples do in some degree govern themselves, they must individually show a greater responsibility before the labor of reason and the judgment seat of history.

Aside from the technical problem of actually making the masses of the people more influential in government, democracy must mean that citizens and leaders show the respect for human personality that our tradition in the West has taught us. This is the weapon of democracy in the struggle for the loyalty of the modern, civilized man. That there

are so many opponents of democracy in the world suggests that, in spite of the brave words of the nineteenth century, the democracies have not done a very good job in this respect. There is, I think, nothing per se democratic in human rights, but it is the test of democracy to show that it knows and solves the social problems connected with rights better than other regimes.

The criticism of democracy is in the nature of a taunt. Democracies claim so much for themselves, it is said, but look at what has happened. It is not any different after all, so why not try less ambitious regimes which will make the trains run on time, even if they do not win wars? The critic notes the failure of democracy on the ethical level. Democratic goals are poorly, or bombastically, stated, and they are poorly realized in practice. Its most learned exponents—the professional students of society—are evasive and noncommittal on moral issues. In less sublime theaters than the academic, it is argued that the struggle for equality becomes a single phase of an immoral struggle for power. American life, some say, has degenerated into a struggle between competing oligarchies and pressure groups. Again, on a new front, those in power are moving forward to a greater control over the mind of the citizen, so that this implicit suppression makes meaningless popular participation in government. Techniques or means tend to absorb ends, and finally ends or goals are merely verbal tokens in the struggle for power. The reconciliation of the interests of class or groups, which has been so central in the doctrine of progress, becomes in itself one of the symbols of class imperialism. Finally, it may be suggested that the modern state is so complex that no single agency, whether popular or bureaucratic, can control it all at one time. The nerve centers of the state, so to speak, are scattered about in odd places in its anatomy. Administrative procedure, perhaps, has a life all its own.

The problem so stated is depressing enough. If democracy is to remain the aspiration of humble men and women throughout the world, it must show rare skills on the different levels of politics. Obviously, we need social inventiveness just to make the government of the people more real and to render fallacious the plausible argument for the irresponsible oligarchy. As all labors in time, perfection cannot be expected; but greater achievement can. If new techniques of democratic government are needed, we cannot be respectors of tradition as to techniques. T. S. Eliot has argued that every tradition must be subject to the criticism of an orthodoxy. Tradition must be refined, as metals are refined in the process of manufacturing.

But when we move beyond the level of political technique, we enter the kingdom of ends. We are discussing the philosophy of political goals; we are, like Plato, inquiring into the nature of justice and the

practicability of realizing it here and now, or sometime in the future. Reason is the orthodoxy which must be used to criticize the tradition of justice. It is the work of reason to validate, to add and subtract from our conception of nature. Reason must be the modernizer of the democratic tradition. Our Christian tradition of justice stands for us today as a great conservative symbol; it is the point, I believe, to which we must return in order to face adequately the issues of the present.

With so much revolution going on around us, it is difficult to tell who are today the intellectual revolutionaries. But if we return to the Marxian dream of a generation ago, such a suggestion as I have made would be the essence of reaction. The intellectual revolutionaries demand, as do others, a solution of our problems. At bedrock the issue involves the kind of values which would find their way into practical politics. In specific detail, it is a question of the kinds of freedom that will be tolerated by those in power. The materialist—the modern revolutionary—would deny in general the wisdom of tradition, even when subjected to the orthodoxy of reason. But, of course, as long as we have the totalitarian rejection of tradition, reason, and morality, it is difficult to distinguish the conflicting parties within democracy itself.

Let us assume that the great historical continuity in the West is in the field of principles, or reasonable and intelligent appreciation of living together in societies. We must hope, therefore, that the time will soon be here, if it is not already, when we can examine again our democratic ends and our whole scheme of political values. Let us hope that we can proceed from freedom as a generality to the detailed construction of a democratic life in which men in all justice can recognize that they are free. But such a purpose implies the use of sound reason and a fruitful imagination in the consideration of ends and means. For one thing, we should study those minority groups which are believers in the tradition of justice and which are essentially democratic in outlook. For it is here rather than in the inner circles of power that the conception of a new society is most real. Our task is the examination of the issue of freedom in industrial and urban society and the conditions of freedom and justice for those who live on the land. From the narrow question of the ownership of those things which make family security possible, we must proceed to the world-wide questions of freedom of all peoples; in other words, to the end of imperialism and the regeneration of the politics of power. Even if we agree with Jacob Burckhardt that there has been no progress in man's moral sense, we can still insist that we should use what moral sense we have and that all moral appreciation is expressed under particular social conditions.

For the social scientist the challenge is very disturbing, for it means

that the student of society cannot be content with the collection and organization of information. It means that such labors are only one-half of his task. It means that the other half is the consideration of the ends approved by democracy and the means adopted to bring them closer to historic realization. For many, social science has lacked poetry because in its concern for the average it has ignored the imagination. Social science has lacked religion because it has ignored the problems that the religious approach to society inevitably raises. And finally, the scientific quality of social science has suffered because it has not faced the problem of ends in organized society. It has indeed at times pretended that there is no philosophy worthy of attention. Because of these things it has been unable to offer insight to those who seek it. Some have even argued that social science has been as traditionless in the large sense as the traditionless people among whom it has labored.

I think that I may close my remarks by taking a saying from Aristotle's *Ethics* (Book IV, Chapter IX) that "you must have a right end, [and] pursue it in a right manner and right time."

## DISCUSSION

WESLEY C. MITCHELL: To one of my upbringing, Professor von Beckerath's paper is full of nostalgic charm. It describes regretfully the disintegration of old faiths that formerly bound men together in a common brotherhood, at least in theory, and laments the consequent decline in the mutual understanding upon which social unity depends. But the paper recalls also the way in which Thorstein Veblen treated the same theme forty years ago.

To Veblen the fundamental factor in producing our cultural schism has been the gradual rise of the "machine process" to a point at which it rivals "business enterprise" as a factor in controlling the daily work and therefore the habits of thought of a modern population. Professor von Beckerath agrees with Veblen, I take it, that "the cultural growth dominated by the machine industry is of a skeptical, matter-of-fact complexion, materialistic, unmoral, unpatriotic, undevout."[1] He agrees also that these characteristics are incompatible with the habit inculcated by business of thinking in terms of natural rights as authenticated by precedent. A marked difference of substance between the two treatments does not appear until one asks: What can be done to restore harmony between the industrial masses and the business classes?

Veblen's answer is that nothing can save the old order. True, large-scale war with its overpowering appeal to more primitive impulses may stem the spread of materialistic thinking; but it transfers power from business enterprise to the state and leads to impoverishment. Barring that cultural suicide, business enterprise will die a lingering death. It cannot dispense with the machine process from which it draws its gains. It must therefore tolerate the cumulative growth of a habit of mind in the "underlying population" that will eventuate in a reorganization of production for the use of the workers—not for the profit of "absentee owners."

Von Beckerath's answer is that of a scholar who holds fast to the faiths of an earlier day. We must influence the interactions of ethical forces and economic forces "so as to facilitate the restoration of a reasonably stable society." In religion and philosophy we must "repress negative tendencies." In education, we must insist "on high standards of performance and behavior in building reliable characters imbued with a sense of social responsibility." We must use "our mastery of the industrial arts in town-planning, in relocation of industries, and in the reshaping and relocation of agriculture." We must organize methods of filling the enlarged leisure provided by modern industry with "religious, intellectual, esthetic, political, and civic interests." We need businessmen who understand that private business "can survive as such only when it continues to bring the fruits of technological progress quickly to the consumer." We need labor leaders and followers who "understand that labor can expect from a capitalistic business system lasting employment at good terms only when it recognizes the structural necessities of this system with regard to profitable operation, and sufficient capital accumulation, and absence of arbitrary social disturbance." We need a disciplined and devoted civil

[1] Thorstein Veblen, *The Theory of Business Enterprise* (New York, 1904), p. 372.

service; also perhaps "some rearrangements in our constitutional, parliamentary, and administrative processes." A judicious and resolute combination of these measures may re-establish "community of higher purpose between different classes and groups," and so help to solve social problems—political and economic, domestic and international.

Emotionally I want to believe that von Beckerath's liberal program is feasible and effective. But to do so would be wishful thinking on my part. No one supposes that we shall give up the machine process. I am far from sure that Veblen's brilliant analysis of the habits of thinking it drills into people is sound at all points. At most, this analysis is a statement of tendencies. We do not really know much about the relative influence of "nature and nurture" in forming our minds. Veblen thought he could understand the thinking of both business enterprisers and machine tenders, which should mean that the two universes of discourse are not so widely separated that mutual understanding is absolutely precluded. Good will of von Beckerath's type is not uncommon among men and not without influence on their behavior. But I cannot believe that good will is potent enough to unite us harmoniously. On the other hand, I get the impression that von Beckerath exaggerates the social unity of the past, and thereby makes the disunity of the present seem more appalling than would an historian familiar with old conflicts. After discounting both presentations vaguely, I cannot persuade myself that von Beckerath's remedies, which Veblen would have called "pragmatic romance," can be put into effect on a scale and with a thoroughness that will establish a "community of higher purpose between different classes." The future of a "unified world" bids fair to be as full of social conflicts as the past has been, and just as interesting. I cannot forecast what will happen; but our successors will have at least as much sense as we possess and I doubt whether they will make a worse mess of affairs than our generation has made. Even we are managing to survive.

My fumbling with this issue is due to sheer ignorance. I do not know enough about human nature and human behavior to arrive at any conclusion in which I can feel confident. Probably no one knows enough—a guess I hope someone will prove to be wrong. To me the chief interest in the difference of outlook between Veblen and von Beckerath is that it affords one more demonstration of our desperate need for better social sciences than we now possess.

That remark takes me on to Professor Arthur Salz's reflections upon the present position of one of these sciences. It is a common practice among economists who review the status of their discipline to lament its shortcomings. No doubt the practice is wholesome, for our attention should be focused upon our sins of omission and commission rather than upon our successes. But I recall no one who has dressed so dark a view of economics in so bespangled a style as Professor Salz achieves.

To start with, he regrets the "exuberance" of quantitative measurement, which he fears "will kill genuine reasoning and leave us stranded with a slide rule and a table of logarithms as the only sources of cognition." At the risk of surprising Professor Salz, I agree heartily with his dictum that "figures and proportions are the beginning, not the end of reasoning." So far as I

know, other quantitative workers would say "amen." Seemingly he does not know us or our work very well. I hope that explains his poor opinion of what we do and what we are. As he puts it: "The escape into arithmetic and geometry tends to deprive economics of its humanitarian foundation and the economist of character."

Another trouble is that "modern economics is keyed for action." I have always supposed that the importance of economics derives from the contributions it may make to welfare. Is not that its "humanitarian foundation"? And does not contributing to welfare involve action? The real trouble on this score, as I see things, is that too many among us urge action before we have acquired sufficient knowledge of the practical problems we want to help solve, including their quantitative aspects. Careful deliberation and thorough realistic research are certainly called for before we assume the responsibility of giving advice in the name of our science. Professor Salz might have preached a telling sermon on that text.

Further, modern economics is deficient in vision and in imagination. It turns out ephemeral "Tracts for the Times" instead of "ponderous tomes, the ripe fruits of seasoned reasoning." It deals with the short run, not with the long. The economist is over eager "to be simultaneous with the events." I am not sure about the validity of these charges and of course Professor Salz has no space to adduce the evidence on which they rest. Perhaps my doubts have as much justification as his assertions. Nor are tracts for the times always frivolous. I think with a little trouble I could cite tracts that have contributed to economic insight in every decade since the three pamphlets on rent were elicited by the corn law debates of 1814-15. I wish Professor Salz had put his emphasis on seasoned reasoning, and added that the more concisely its results can be adequately stated the better.

Finally, "government and economics have drawn close together and live in a real and, to a large extent, personal union." Will not this statement be greeted with enthusiasm by the shades of Adam Smith, Malthus, Ricardo, and most of their followers? These men were critical of their governments, as Professor Salz says, but they tried to make benighted rulers see the light of economics. To have economists given posts of influence within the government itself was just what they wanted. I cannot see how Professor Salz himself can reasonably object to this triumph. Of course, he might justifiably protest against the kind of economics some of these recruits bring with them. What is wanted is discriminating qualitative analysis of the economic theories put into practice, not a condemnation of a personal union between economics and government.

Frank H. Knight: On the main papers of this program, I shall not offer much specific comment. With the general argument and position taken I am in hearty accord on most substantive points. There is one exception, which I feel to be important, and in the time at my disposal I may try to indicate what it is, though not to present any adequate discussion of it. I refer to the view, which is common in academic and literary circles, as to the relation of ethics and religion to the crisis in Western civilization, and which finds more or less

explicit statement in all the papers read, especially that of Professor von Beckerath. This view finds the root of our troubles in a decay of ethical idealism, which in turn is attributed to a decline in religious belief or faith, finally explained by the growth of science and "materialism," and perhaps a false conception of freedom as an ideal.

The degeneracy of the race, in moral and other respects, is the ancient and perennial wail of those who have their reasons for opposing change, and specifically such change as they see taking place. To such people any change in ideals is merely loss of all ideals, or their corruption. Of course, as has been observed, there is an element of truth in the most erroneous doctrines, and progress in the best meaning creates serious problems. But the general theory seems to me merely false to the facts of our present situation. Our difficulties do not arise out of decay of ethical idealism; and I do not mean merely the stock and usually true answer to the complaint that "things aren't what they used to be," namely, that "they never were." The cause of our difficulties is rather the opposite fact, or two facts, that we have much higher ideals than any other civilization known to history, and that we take our professed ideals seriously, demanding that they find expression in the realities of economic and political organization and social relations. The primary fact is that failure to realize our high ideals to a satisfactory degree or at a satisfactory speed has resulted in discontent and the threat of social disorganization. More accurately, disagreement as to the cause of this failure has given rise to recrimination and the threat or the fact of overt conflict. In other civilizations, a few thinkers, such as the Stoics, have professed ideals of human dignity, freedom, and equality, similar to our own, and this has commonly been true of the spokesmen for religion; but they did not really mean it, except in an other-worldly or purely "spiritual" sense, or as literary-utopian speculation, or mere ritual.

The touchstone, on all such matters, is the practical attitude toward the class structure of society, specifically serfdom and slavery. Neither classical nor Christian thought ever seriously opposed such institutions, except in situations where they had already been abolished; and their abolition has been effected through forces which both religion and the intellectual elite opposed with all the energy they could muster, and by fair means or foul. This is the logical position of any spiritual religion or contemplative world-view. Such "material" considerations as a decent standard of living and a self-respecting social status for the masses are regarded as a matter of indifference in terms of the higher or real values, and if the masses take a different view, their presumption is to be punished as sin. Outside of recent West-European culture no serious effort has been made to carry equalitarian idealism into effect in the political or other aspects of social order. Historically speaking, the active ethical mores of our culture are not derived from Greek thought, and even less from the Jewish-Christian religious tradition. They arose in modern times, specifically in the movement called "rationalism" or "the enlightenment," antireligious in tone, and more particularly through the peculiar English development. Here the Renascence came somewhat late, and the Enlightenment a full century early, compared with France, which followed

England and led continental Europe. Thus the two cultural revolutions were virtually fused into one, and the religious Reformation also took a distinct course.

As to organized religion, its sociological function is always conservative; it sanctions whatever social structure and mores are effectively established, merely striving to get people to conform and be content, and to act humanely. The view of religion as the opiate of the masses is scientifically correct, with the addition that it is sometimes expected to function as a sedative for the classes also. Organized religion never has a dynamic or progressive or equalitarian ethic. A few prophets and minor sects are exceptional, but only in a naive utopian sense; and established religions co-operate with secular forces in suppressing or exterminating, usually with success. The genuine exceptions even in our present-day society are relatively unimportant. Our ideal of justice is not the Greek or the Christian ideal, based on social classes and relations of command and obedience. The Greek "democracies," so-called, were antithetical in this essential respect to our ideals, and even to our performance. And this is even more strikiugly true of Judaism and Christianity, as working systems, wherever they have been in a position to function as such. When the Renascence and Reformation, themselves consequences of underlying more fundamental changes, destroyed ecclesiastical absolutism, the churches merely shifted their position to the support of political absolutism by the doctrine of divine right. Democracy, economic liberty, and freedom of thought and expression were achieved in spite of obscurantist religious opposition, and resistance continues, virtually to the extent that churches have influence and power. What is peculiar in our religious and moral situation is less that so many people profess doctrines, moral as well as religious, in which they obviously do not believe, than that both their professions and their conduct embody contradictory ideals. The practical bearings of this twofold discrepancy cannot be developed here; I cannot even show in detail why the so-called "golden rule" sheds no light on practical social and political issues. And I can only point out assertively that the loss of faith which is serious in our social situation relates to the naive eighteenth century confidence in reason and democracy. The working ethic of our civilization is sportsmanship, which is entirely alien to the religious spirit in any form.

To put it briefly, and unpleasantly, the Western peoples have not yet proved their capacity to realize the new and high aims of democracy on the scale of the modern state—to achieve justice and effective government through free discussion—and tend to appeal to force, potential or overt. In my opinion, the international and world wars of this century developed as alternatives to factional and class war. In our American history, the only acutely serious conflict which has ever come to an issue was settled by force, by war, carried to the virtual exhaustion of the weaker party. The issue, interestingly enough, in view of the date—the later nineteenth century—was slavery; and as to religion, the churches themselves or their members divided along the boundary between the region where slavery was an established institution and that where it was not. I am not saying that democracy has been proven a failure in the

historical-cultural situation of Great Britain and its dominions or countries settled by British stock. The issue is still in the balance. But elsewhere there are not many or large regions or peoples where even formal democracy has not either failed outright or has never been tried, and where its achievement is still a dream for the distant future.

Time does not permit me to explain or even explicitly to point the moral, but only to mention well-known facts, which people do not like to face. But I wish to assert that the human failure or weakness implied lies far more in the intellectual realm than in any lack of ethical ideals. The popular synonym for these is "good intentions," and without implying any high and universal moral fervor, I deny that there is any practical shortage of that commodity. Nor do I imply that there is a sharp distinction between intellectual and moral judgments. If time allowed, I should like to discuss that philosophical problem. I should find the fundamental nature of freedom in the intellectual life, in the fact that genuine or rational opinion cannot be coerced, and ultimately in the difference between making a statement and making a noise—or the occurrence of a noise—since determinism would also eliminate "making" anything. Intellectual, moral, and aesthetic judgments overlap, and each class can be so defined as to include the other two. I should deny the reality of ideals separated from knowledge of the conditions, mode, and limits of their realization. Such "fancies," without significance for action, may have value; but it is aesthetic value rather than ethical or practical. The rational man does not approve or disapprove an unalterable course of events, such as the weather. (Of course, I am not asserting that men either are or should be purely rational.) The intellectual side of the problem is itself twofold, the choice of ideals, and the choice of procedures for their realization. Taking the ends as given, the problem of procedure, viewed as the use of means, is the field of technology and economics. If the popular but misleading contrast between "spiritual values" and "material satisfaction" is to have any meaning, it must refer to the difference between ends as actual objects of desire and the critically examined values of morals and aesthetics.

The peculiarity of modern democratic ethics and its major difficulty is that its supreme value is freedom, which is not defined by any specific content, but means the right of individuals and voluntary groups to be the judge of their own values and to pursue values of their own rational choice. On the social side, the problem is that of free association. But freedom presents the paradox that while only in society can free beings develop or lead a tolerable existence, the unalterable conditions of associative life—particularly the conditions of effective co-operation—require the members of any society to have many values in common. Free society must rest on agreement, on rational consensus, and, in particular, agreement upon the terms of association. But these are largely determined by social-cultural inheritance, which is highly diverse between innumerable groupings. In terms of sociology and history, groups are much more real than individuals, and the conflicts of interest which generate social problems arise far more between groups than between literal individuals. The family, in some form, is the minimum unit in a continuing society; familism would be more descriptive than individualism of our liberal

social order. But larger groupings in great variety are also essential; of these the state, based on territorial sovereignty, is now concretely the most important. A realistic study of social problems must be focused on the conflicts of interests and associated differences of opinion about rights which menace the social order, on the institutional system by which conflicts are adjudicated or held within limits not too destructive, and on the possibilities of changing both of the former through discussion. (Discussion must be distinguished from persuasion, which is a form of force, and ethically one of the lowest forms, since its basis is deception.) In our society, the major conflicts happen to arise in the economic organization; but these are not ultimately different from conflicts in other aspects of association—play, and the religious, intellectual, and "social" life.

The reality of values, in the abstract, is never practically in question, though some men pretend that values are unreal, because they have argued themselves into a mechanistic world view—and most idealistic or theistic philosophy amounts in practice to the same thing. All real discussion is free, and runs in terms of values, since propositions beginning with the words "I want" do not constitute discussion, and cannot tend toward intellectual agreement where there is disagreement, any more than can mere noise. This freedom cannot be denied without asserting it, since machines do not deny, as they do not assert. It follows that there is no point in preaching values in abstract terms. Everyone who is not a self-declared enemy of free society formally accepts not merely truth, beauty, and goodness (if allowed to define them) but also far less abstract social norms such as freedom, peace, order, security, progress, efficiency, and justice—the last so defined as to limit inequality and to give everyone the right to a "decent" standard of living and a "fair" opportunity for self-realization. The real questions arise in connection with the definition of such norms, and their application in economic, political, and social life. It is precisely over values that men fight rather than mere desires; and preaching which intensifies the claim to justice, for example, or freedom—by which people usually mean power—without defining them in terms of possibilities of realization, can only make social conflict more acute. With respect to general social ideals, as well as concrete economic and other interests, the problem lies, as Professor Salz has well observed, in overlapping and conflict, and the consequent necessity of giving up something of other values to secure greater realization of any one.

In sum: Social problems arise out of conflicts between values, associated with differences of opinion. An ethical solution of any such problem comes through free discussion, which necessarily looks to superindividual norms, not to mere preferences or mere facts. Ethical society is association on terms arrived at through free and rational assent to change, which must be continuous and gradual. All parties must have power, as well as freedom, to participate effectively in social decisions. The decisions must be made in the light of the broadest possible view of the interests and ideals in conflict. Discussion of social change must envisage both the living and the unborn, the present situation and the future progress of the particular society or culture, and of civilization at large. This idea of progress, specifically through the rational

and co-operative pursuit of rationally chosen ideals, is also a unique feature of Western civilization in the historical period beginning with the Enlightenment.

FRANK D. GRAHAM: The classical economists so successfully imposed their ethics on succeeding generations that the very word economic carries with it ethical connotations of which we are now largely unaware. If we try to eliminate ethics from economics, and assume a pseudo-scientific ethical objectivity, we deprive the word economics of most of its significance. In the broadest sense of the word there is, of course, an economic aspect to everything; viz., the means of attaining any desired result at the least cost to the desirer. This use of the word makes economics synonymous with a mere efficient technique toward any end, but this is far from covering the accepted connotation of the word.

If economics had no ethical connotation the most economic means of acquiring a competence might be to murder one's feeble but opulent father, provided it were done in a technically efficient manner; that is to say, without much trouble to the parricide and without any prospect that the act would be discovered and punished. The vikings, according to Veblen, organized their expeditions as monopolistic business enterprises on lines which modern corporations or trade unions might, and do, emulate, and, in the degree of their early success, they probably raised the Scandinavian standard of living above the level which the most assiduous labor could, at the time, have provided. From a national point of view, and if we insist on ethical neutrality, their methods were economic.

We refuse, however, to grant the use of the word in connection with any such activities as those above described. If technical perfection is not enough, what then do we mean when we say that a given action is economic? Clearly the word is used only with respect to processes which, in a given state of the industrial arts, attain a valued end at minimum cost to humanity at large.

But who is to say what ends are valuable, and who determines cost? There would be few today, at least among Protestants, who would not declare that the Middle Ages indulged in uneconomic outlays on cathedrals. But, if it be granted that the chief end of man is to glorify God and enjoy him forever, any such judgment is certainly open to question. We cavil at what we call the uneconomic practices of the Mercantilists but, to the end of the military power of the state relative to its rivals, their measures were far from being as badly conceived as economic critics have alleged. It is evident that economics, as we use the term, implies a specific end, that it is, itself, a form of ethics which regards the interest of any one man, group, or nation, as of precisely equal import with that of any other. Economics rests squarely on a cosmopolitan Utilitarianism and there is no way to get it off without a breach of all of the concepts that are the very essence of our discipline. Every individual is the judge of what is useful to him, establishes his own ends, assesses his own costs, and, provided no private individual or group in any way coerces others, it may be presumed that every man will maximize the spread between his pleasure and his pain. Since costs must, in the nature of the case, be self-

assessed, this will maximize total satisfactions relative to total costs. To assure this result governments are set up to prevent private coercions. The very word economic thus implies a specific system of values and it has no intelligible meaning apart from that system.

The economist as a philosopher, and not merely as a technician, is, of necessity, committed to a cosmopolitan individualism. This may not be the whole of his ethics but it will certainly be a major part of it. His politics, also, derive from his ethics. Equality of political opportunity, equality of rights and obligations for all men—these are the political counterpart of free economic competition.

The ethic of classical economics and democratic politics seems to me to be the only ethic that can command general support and to be likely, therefore, to promote solidarity. It is, to paraphrase Jefferson, the only ethic that does not fly in the face of the rights of man and the only one, therefore, which offers any hope of surcease from devastating conflict. A so-called "economics" which is concerned only with output, regardless of the human cost, and a so-called "politics" which loses itself in a struggle for domination, have either, in a species of institutional determinism, lost contact with values or they have cajoled, or forced, people into an acceptance of values that they are afraid to examine.

The acceptance of the ethics of economics by no means precludes a reverence for transcendental values. The economic man is not necessarily materialistic; he is merely rational. All that is assumed about him is that, whatever his desires may be, he will proceed to realize them at minimum cost to himself. The role of government, in the interest of all, is to see that he does not realize them at the expense of others. An economic man may prefer, with its attributes, a modest competence to great riches; he may love leisure more than possessions; he may desire greatness by being the servant of all. He sets his own ends and, seeking to realize them as fully as possible, he makes a rational use of his resources. His ends may be philistine or they may be what, in the Christian tradition, we call noble. It is the function of transcendental ethics, consistent with that which we use in economics, to establish the higher range of values. But, if we could recapture, and extend, the acceptance of merely economic values we would have lifted the world out of the slough of despond.

The economic and the peaceful are synonymous since all forms of coercive power are, in the very nature of economics, abolished, and coercion, of course, is of the essence of war. Political science, as distinct from *realpolitik*, has no other function than to establish the conditions under which men could realize their aims only by truly economic (noncoercive) activity, with privilege (a favorable status regardless of economic merit) eliminated.

The ethics of free competition in a democratic polity rests on the axiomatic equity that he who makes should benefit and that he who breaks should pay. This is the only basis on which a transcendental ethics can be built without running afoul of a just positivism. If we are prepared to hew to this line the postwar world may reverse the modern reversion to barbarism.

From what has been said it may be seen that I am not in full agreement

with the analytical part of Professor von Beckerath's paper but I would enthusiastically endorse his proposals on education since it seems to me of supreme importance that we imbue our present and future citizenry with the principles on which a civilization, as distinct from a technologically competent barbarism, can alone be built.

I would not want to put into the mouth of Professor Salz words that he did not intend to utter but I should like to enlarge on his dictum that economists in our time have lost any firm grasp of fundamentals, have sought to escape from the "trammels" of the ethics which, as I have tried to show, can alone give any meaning to the word economics, and have become mere principleless technicians. They may be endowed with a vague good will but their *ad hoc* solutions of any posited problem are often quite alien to the spirit in which classical economics was conceived. The solutions have, inevitably, normative implications but what these are is seldom asserted or even realized. The several solutions that economico-political practitioners propound, being based on no general principles, are not infrequently quite inconsistent with one another. The totality of "economic policy," so-called, therefore hampers rather than furthers progress toward any rationally-conceived social end.

Until we can redefine the word economic, as I hope we shall not try to do, political economy and political science (as contrasted with *realpolitik*) cannot be incongruous but are, in fact, supplementary disciplines articulated toward the achievement of freedom as the first of all values. They both rest on ethics. To adhere to the ethics implicit in them is the sole hope of attaining social harmony.

It seems to me that there is no conflict between economics and any ethics which could have widespread appeal. The trouble is not that economics has been in conflict with ethics, or that folkways have been changing, but that evolving institutions have led us to forget the rationale of our economic system and to mistake business efficiency for economics.

# EDUCATIONAL FUNCTION OF ECONOMISTS AND POLITICAL SCIENTISTS

## EDUCATIONAL FUNCTIONS OF ECONOMICS AFTER THE WAR

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I start with the belief, first, that there will still be liberal education in the social sciences after the war and, second, that economic teaching faces a major re-examination, in which problems of teaching method will be overshadowed by the problems of what the coming generation needs to learn; and since what people need to learn depends mainly on changing conditions in the economic world outside the classroom, we may find ourselves dealing first with these changing conditions, and only afterward with the classroom adjustment to them.

### I. *The Basic Importance of "Problems"*

Conventional economics is divided into principles and problems. Originally, in the case of Quesney, Adam Smith, Malthus, and Ricardo, the principles were themselves derived from, or closely bound up with, consideration of problems of economic policy which were live issues in a given historical setting. These principles were presented as general laws, thereby gaining a peculiar academic dignity; and in time their relation to their original practical setting grew dim or was forgotten.

In the postwar generation, economic students may rightly insist that their study be focused around the major problems of their own time and place. They will also crave, consciously or unconsciously, some orienting framework of ideas which can give coherence to the whole picture, provided this framework is relevant. The traditional treatment of numerous special problems too often gave the student a multitude of trees and no forest: disconnected cases unrelated to common principles or common criteria of judgment. The present generation has two dominant sets of problems: those of war and peace; and the overshadowing domestic problem, which may be given decidedly comprehensive scope if it is defined as the problem of energizing the economy to a high level of employment of its resources, in the creation of products having the largest practicable amount of service value.

Consideration of problems in such a framework, by deeply inquiring minds, will lead to theoretical questions, just as it did with Ricardo. Therefore, pedants need not be unduly uneasy for fear theoretical problems will lose their importance. It is only the traditional ready-

made answers—or methods of evading the need of an answer—which will lose standing. This will make trouble for the pedant who is faced with problems to which he does not know the answer. But if a new age is ever to work out answers to its urgent problems, pedants must necessarily suffer from obsolescence of their intellectual capital goods. By way of example, one of the most vitally important theoretical problems for the postwar period is the problem of the approximate elasticity of demand for labor, both in particular industries and trades and in the market as a whole. Can or will employment be stimulated by reducing wage rates, or curtailed by increasing them? Is the answer different for very low wage rates and for very high ones? Is it different for a self-contained economy and for one heavily dependent on exports? Popular thought implies quite contradictory theories on this point, while academic literature is almost barren.[1] To take another illustration, one way of approaching the theory of the market as an organizing force, is to ask why we do not let it run a war on supply-and-demand principles, as we let it run ordinary peacetime affairs.

## II. *Relation between Economics and Political Science*

Using the method of projecting observed trends, one would easily reach the conclusion that politics will soon finish swallowing up economics. Economists used to have a comfortable amount of the feeling that politics proposes, but something called "economic law" disposes. Nowadays, they are forced to entertain an uncomfortable suspicion that economics proposes and politics disposes. Market forces operate on sufferance, and the "economic law" that decides what happens consists largely of things like the policies of the Triple-A and the decisions of the Federal Trade Commission, whatever qualms that may give some economists.

However, the economists' trade union has a keen eye for its jurisdictional vested interests, even if it has not been able to define their boundaries; and we may expect economists to go on dealing with wage adjustments, including the politics of unions and the jurisprudence of wage boards. In return, they may look the other way when political scientists show an awareness of the economic grist that is ground in the political mills. Much economics may go into administrative proposals, to be killed by the economic forces in Congress. This an academic economist may regard as a political act of God, though the Washington

[1] Pigou's analysis in his *Theory of Unemployment* is impressive but can hardly be accepted as definitive. Pigou's basic assumption that wages equal short-run marginal productivity seems inescapably contrary to fact. On this basis most businesses would be "in the red" most of the time. Moreover, his treatment is obviously unteachable except to the limited fraternity of mathematical specialists. Keynes's defense of wage rigidity deals with general movements in one direction (downward). Thus it is not a rounded theory.

administrator is not likely to look on it with the same detachment. In short, our politically-determined economics and our economically-oriented politics may maintain academic separation, if they try hard enough.

More seriously, however, if education responds to the needs of the age, it seems fair to expect that the relation between economists and political scientists may become less and less that of custodians of insulated disciplines with academically defined boundaries; and more and more that of partners in attacking problems of policy which involve both economic and political or administrative angles and cannot be finally settled from the standpoint of either discipline, taken by itself. We shall not get very far if we stick to the attitude in which the economist regards his part of the job as done when he has decided what would be desirable from an economic standpoint alone while the political scientist is busy studying the workings of political machinery which, from the economist's standpoint, seems to have a habit of grinding out measures of just the wrong sort. Or we shall not get far in resolving the political difficulties if the students of politics take refuge in the idea that these are rooted in the ills of the economic system, and cannot be cured until the economic system is reformed, regardless of the fact that reform of the economic system requires political action.

Political proposals cannot be properly settled by merely asking, for example, whether they agree or conflict with our traditional conceptions of democracy. It is equally important to consider the economic job which the government has to do, and to adjust our mechanisms so that they may be able to do the job while preserving the democratic principle, in some practicable form and in such degree as the American people are currently capable of achieving.

For example, control of inflation and reduction of business fluctuations require a coherent economic policy rather than piecemeal measures; and some parts of this policy require prompt and flexible administrative action in response to changing conditions. This needs to be combined with democratic accountability; but if the machinery of accountability hamstrings administrative unity and flexibility, the government cannot do its job.

## III. *Market Values vs. Independent Appraisal of Objectives*

It is impossible to look realistically at the problems we shall face in the postwar period without realizing that traditional conceptions of economic objectives and standards of value are bound to be disturbed, and in some respects reversed. The overwhelming preoccupation of those who are looking forward to the domestic postwar adjustment is

not goods as such, but jobs. The typical calculation starts with an objective of, let us say, 57 million jobs in 1947, and goes on from there to the volume of production which must be created and disposed of if that many workers are to find employment. The answer takes the shape of a finding that we must produce a certain volume of real output—say, for example, the equivalent of a real national income of 140 billion dollars in 1943 prices—not because we calculate that that is the amount of goods needed, or the amount that will be demanded, but because that is what 57 million workers could turn out. This flatly reverses the ordinary economic way of calculating whether a certain commodity, or a certain volume of commodities, is worth producing. It means that, regardless of conventional economic yardsticks, people have decided that a reasonably high level of employment is a paramount necessity, in its own right.

Of course, the war is giving us a great deal of experience with standards of value independent of those of the market. Materials and manpower are allocated among industries according to a rating of the essential or nonessential character of the products as aids to the war effort. After the war, military considerations will demand a hearing with respect to the location of certain industries, or the decision whether or not to maintain them in this country by protection or subsidy. In such decisions, the word of the general staff should have weight. But we should not stop there, because the State Department, for example, may offer testimony to the effect that, while a protective policy might give us an industry of some slight military value, its reactions on other countries would be such as to endanger the willingness of those countries to co-operate after the war—a willingness on which the chance of future peace depends.[2]

Furthermore, we have been forced to treat our working manpower as a national asset; and the need of conserving this asset will not be forgotten completely the moment the guns go silent. Therefore the policy of the "social minimum" will undoubtedly receive a great impetus, both as a measure of conserving manpower and as a measure of reducing unemployment by maintaining diffused purchasing power. It could, however, be self-defeating in several ways. Liberal benefits might make some workers prefer unemployment. Idleness would outbid employment in marginal industries struggling to get on their feet after a depression, which can offer only part-time employment. This would be especially true in regions where the scale of money wages and living costs is low.

We shall enter the postwar period, having demonstrated to ourselves that we possess vastly more productive power than we have ever before

[2] This theme was more fully and ably treated by Mr. Condliffe in his paper on the organization of national economic power.

utilized. When the fighting ends, possibly five years' accumulation of increased productive power will be suddenly released for civilian uses, making available at one stroke a standard of living considerably beyond the highest we have ever realized (even if it is substantially less than the most optimistic estimates). Many of the things we shall want are things individuals buy in markets, but many are not—improved services of public health and public recreation, for example. And many are things vitally needed by people who do not have the money to buy them. It seems inevitable that there should be a searching reconsideration of the question of what we want an economic system to do for us in the light of this vast increase in potentially available productive power and altered social and national objectives or requirements. I am not suggesting that final answers will be easily and quickly formulated. What I am suggesting is that teachers of economics will need to raise this question in their classes; and that if they answer it by conventional formulas based solely on satisfying commercial dollar demand, they will not be facing the realities of their time.

One of the things that is wanted is something called "security," including greater security of employment as well as compensation if employment fails.

Back of this are still more basic questions. What are the economic roots of war and the means of protecting peace? What is there in our economic system that is worth fighting for? What basic attitudes are fundamental to a workable system? How do self-interest and loyalty combine in a workable system? What kind and degree of loyalty does a system need to command in order to be sound, and does our system meet that test? These questions go far beyond the ordinary conception of the mechanics of the system of business enterprise; but they are coming to be integral features of the mechanism, in the sense that unless they are answered passably well in practice, the mechanism may break down.

The fact that we cannot give neat and definitive answers to all these questions does not excuse educators from raising them, and from recognizing that they are integral concerns of the system of business enterprise. The academic economist is equipped with traditional devices to excuse him from grappling with such questions; but it seems likely that these escapist devices will not hold against the pressures of the postwar period.

### IV. *An Economics of Responsible Working-together*

Some are saying nowadays that we cannot solve these questions, because we do not have a "unified culture." Therefore the only basis on which a working economy can be organized is either the valua-

tions of the market, with its well-known biases and blind spots, or the outcome of irresponsible political pressures, with their equally well-known tendencies toward sacrificing the good of the whole to the temporary or apparent selfish interests of organized groups. And these will lead us into chaos. With due respect to the exponents of this doctrine, I shall contend that this is a half truth, both important and dangerous.

The fact that we have embarked on the adventure of liberty and democracy is sufficient reason why our culture can never be unified to the degree and in the sense that the European culture of the Middle Ages was a unit. Medieval culture was regimented—regimented by material penalties, in this world and the next, wielded by a Church which had power over the dispensing of penalties in both worlds. The ideological machinery was in the custody of a minority of scholars, trained in prescientific mental disciplines. It would be a waste of time to discuss whether we should go back to that kind of unification. What we need to do today is to find a basis which will appeal to millions of people, with varied cultural origins and social backgrounds, who do not think like medieval schoolmen, who are free to disagree, but who disagree less in their codes of feeling and action than in the intellectual creeds or reasons, or rationalizations, with which they support these codes. We need to find a basis on which people of this kind may find enough sense of common interest and enough basic like-mindedness to build a workable world on.

One idea is that scholars should find unity among themselves, and then pass the results down to what Veblen called the "underlying population." This appears to be going at it wrong end to, displaying an unconscious arrogance, and failing to recognize that, whatever the modern American cultural unity may be, it will be democratic. The scholar can play a very important part if he will accept the more modest role that the democratic principle assigns to him: that of interpreter and catalyzer; of leader in the democratic sense, but not dictator. The task is both greater and simpler than that of achieving unity among scholars, who are a fairly cantankerous lot of prima donnas. The closer each scholarly discipline gets to the underlying springs of action of the common man, the nearer they will be to unity among themselves.

This attitude should come naturally to economists, who have traditionally worked in the spirit of Bacon's dictum: "While philosophers are disputing whether virtue or pleasure be the end of life, do you furnish yourself with the instruments of either." They have been content to let the market decide the uses to which economic goods should be put. I am suggesting that they make a declaration of partial independence from the market, which is a biassed instrument for recording

values, though an indispensable one. But I am not suggesting that they abandon the attitude of "decent respect" for the underlying standards of the people at large.

According to the dominant philosophy of the nineteenth century, not much unity was required in order to build a workable economic world. In theory, our system was one in which every individual looked out for his individual interests to the best of his ability, and he was prevented from doing serious harm by the natural checks of an individualistic system, centering mainly in universal competition. This gave the individual what was often wrongly construed as a license for irresponsible self-seeking. This spirit of irresponsible self-seeking persisted into a new age in which the competitive checks are vanishing or being progressively weakened, and in which group organization is taking the place of the competing individual. These group organizations have power, for good or for harm, which the simple individual did not possess. As a result, irresponsible self-seeking can no longer be trusted (if it ever could be) to build a scheme of voluntary working together. But this system of group organizations is animated to altogether too great an extent by a spirit and philosophy suited to the individualistic era of one hundred years ago. This "cultural lag" is one of the most threatening features of our whole situation.

A similar change has taken place in the matter of international trade policy. New and more powerful methods of interfering with the free course of trade have been developed, and irresponsible use of them can be increasingly destructive. Part of the change is in economic theory itself. Economists used to teach that Mercantilist policies were self-defeating; but the newer economics has rehabilitated some Merchantilist principles. For example, it is admitted that an underactivated economy may gain by establishing an export balance, by excluding imports which compete with home production, or in other ways. What is the conclusion: Not to accept an inevitable trend toward autarchy, but rather to combat it in the face of the fact that single countries may gain by single acts of exclusive trade policy. If international trade is to work in the future, it must be because nations recognize the necessity of making it work to the sound advantage of all, and of making some beginning toward renouncing policies that would sacrifice a workable world system of intercourse for the sake of temporary national advantage.

If a spirit of irresponsible self-seeking remains dominant, then our choice is between regimentation and chaos. If we are to have liberty—which means fairly orderly working-together by free men—it can only be on the basis of a spirit of teamwork and a recognized responsibility for working together. Among all the uncertainties of the future, this

one principle stands out as one of the greatest certainties we can build on. It will stand comparison in that respect with most of our so-called "economic laws," either traditional or modern. It does not deny self-interest or set up altruism as the rule of economic life; merely recognizes the obligation of each self-interest to accommodate itself to the others, on some basis that will stand common scrutiny. Fairly crude levels of this virtue may suffice to keep the economic system from falling apart; but more advanced levels are necessary to build a satisfactory economy.

## V. *Content of Economics*

The foregoing remarks may seem to have wandered far from the matters with which a course in economics must necessarily be mainly concerned. I am contemplating, among other things, a growing tendency toward courses which treat the problems of a civilization and do not confine themselves within the boundaries of the traditional disciplines. But even within the economics courses, if the pressure of the postwar age works in the way suggested, it will mean that we shall not be satisfied to start with the conventional treatment of human nature, which separates out certain supposed economic motives for purposes of specialized study. We shall need instead a more rounded treatment which gives us some basis for judgment as to what the needs of human nature are, and the relative importance to the community as a whole of meeting these various needs in varying degrees. This needs to be maintained in the face of the inevitable and valuable tendency to make economics increasingly statistical.

Going on to matters more directly concerned with the economic mechanism, there appear to be three major areas of theoretical analysis, all of which need to be adequately dealt with. Traditional economics is concerned with one, the modern or Keynesian type of economics with another, while the third remains so inadequately treated that it is almost fair to call it a blind spot or a no man's land. The first is the study of the relative structure of prices and incomes, and its job of allocating resources between different uses. This is the main theme of the traditional economics, and it does not deal with the question of the total amount of economic activity, either "taking full employment for granted" or avoiding the problem in some other way. The second type of study is concerned with the flow of income and expenditure as a mechanism determining the total rate of economic activity. This relationship has been studied for a long time—since the time of the Mercantilists, in fact. Numerous writers have contributed to it, on penalty of being treated as heretics. But it remained for a group including Lord Keynes, D. H. Robertson and others to give it a formulation and a

sponsorship which secured its admittance into the recognized academic discipline, and in this country the Keynesian form appears to hold the field.

The current generation of young economists has in "Keynesianism" a new and powerful orthodoxy, which threatens to displace the old. This new orthodoxy is a tremendously important fact. Not since Ricardo has the stream of Anglo-Saxon academic theoretical economics been refreshed with such a major current so resembling Ricardianism in that it grows out of and interprets new and dominantly significant problems and conditions, and is embodied in a formula both academically satisfying and offering a basis for policy in action. It expresses elements, long neglected because of the too-implicit acceptance of some of the formulas of Ricardian orthodoxy.

What is the moral? I suggest that it is that we give the newer orthodoxy its due as a great reorientation and a great contribution to our tools of thinking, without repeating the former error of too-implicit and uncritical acceptance. Orthodox Keynesianism, with orthodox imperfect-competition theory added, does not answer all questions or foreclose diverse major lines of inquiry. We shall need fresh jobs of constructive heresy, and this time they had better not wait for over a century to be developed and to gain acceptance.

The third area, or no man's land, contains the problems of the relation between the structure of relative prices and income on the one hand and the total amount of economic activity on the other. The older economics dealt with putting resources where they would do the most good, assuming that they would be used somewhere. The newer economics deals with ways of maintaining a flow of income and expenditure in terms of money, but with no guaranty that faults in the pricing structure will not prevent the money flow from being realized in a flow of real production and real income. The connection between the two remains sketchy. There is much discussion of it, but there is not yet an adequately grounded body of theory establishing necessary relationships. And there is every likelihood that groups with monopolistic or partially monopolistic power would be able to pervert any program for ensuring full operation of industry via maintaining an adequate flow of dollar income and expenditure, by simply raising their own price, or wage, and corralling an increased amount of the dollar flow for themselves, at the expense of reduced physical output.

In general, the postwar period seems likely to call for increased realism. The teacher will have a duty to resist the hypnotic effect of abstract formulations with their tendency to anaesthetize the critical faculties as to the degree of resemblance between the symbols and the reality they are supposed to represent—a reality which is usually rough-

hewn and frequently paradoxical. Perhaps the main temptation in the near future will be to deal with lines on statistical charts and forget the reality that lies behind them. I hope that in the treatment of imperfect competition teachers may make use of realistic cost-curves, with special attention to the difference between short-run and long-run variation of cost. This would tend to a truer gauge of the relative importance of different departures from theoretical "perfection."

The widely-held theory of competition is tending toward a condition in which there is, by definition, no such thing as competition in quality, per se, and in which there may soon be only two groups of cases: less-than-pure competition (classed as a form of monopoly) and approximately pure competition (which appears to mean a "sick industry"). If this describes industrial conditions fairly, something should be done about it: our policies should be changed. If the fault is partly or wholly with prevalent concepts of competition, something should be done about that, and the concepts overhauled.

I also have hopes that the stage may be set, as I have elsewhere suggested, for a revival of objectivity and impartiality, at least among economists not definitely attached to some special-interest group.[3] This might occur by way of reaction from a condition which has swung rather far in the other direction. Whether this comes about or not, and whether or not economists live up to their responsibilities as teachers or formulators of teachable doctrine, there has never been a time when the profession bore a greater responsibility for realism, for objectivity, and for relevance to issues of policy which will be vital in the coming decades. These decades can easily be disastrous and are pretty certain to be stormy. Little as economic teaching may seem able to accomplish toward seeing the country through, that little may be important.

[3] Cf. "The Theoretical Issues," *American Economic Review, Sup. 1* (Mar., 1942), p. 11.

# ECONOMICS, POLITICAL SCIENCE, AND EDUCATION

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Our topic covers three fields of knowledge and action, all vast and indefinite. The combination sets a rather bewildering task of saying anything reasonably true and relevant and not utterly trite; and one who says anything about it, needs to say a great deal. I shall not speak of methods of teaching (about which I know nothing), but shall restrict myself to content. And under that head I can only state a few results which must be achieved by social action in accord with sound principles of economics and political science if our society is to conserve and develop its recognized values of freedom and progress, along with the necessary minima of peace and order, and also of efficiency and justice. Nor can I more than mention immediate concrete issues. Of these the most important are doubtless monopoly and unemployment. They illustrate different types of problems, in that monopoly involves acute conflicts of individual and group interests, while unemployment is a matter of intellectual agreement upon effective measures.

My own approach is that of a "teacher" of fundamental economics, with the improvement of content in a secondary role. As I use the word teacher, it refers to an occupation, in which the craftsman presumably tries to earn his pay; it does not mean that learning, the logical correlate of teaching, actually follows as a result. My experience, of some three decades, has raised some other sober reflections in my mind. I fear that the urge to teach is largely a conceit and is a species of the lust for power and prominence, hence one of the immoral ingredients of human nature, a form of original sin. Also, I am more and more impressed with psychological and moral problems in education, and in thinking in general. In economics in particular, education seems to be largely a matter of unlearning and "disteaching" rather than constructive action. A once famous American humorist observed that "it's not ignorance does so much damage; it's knowin' so derned much that ain't so." But a purely negative conception would be an oversimplification. It seems that the hardest things to learn and to teach are things which everyone already knows, which are banal when explicitly stated. The main "principles" of economics are obvious, even insultingly obvious, to people at the intellectual level we should like to assume in the literate public, as well as university students. The problem here is to get generalities to "carry over" into political discussion and action, the field in which our two sciences are practically significant. In other connections, as will be shown, the problem may have the opposite form,

of keeping professed principles from being taken literally or too seriously.

The situation is illustrated by the great American political issue of protectionism. No one denies the general advantage of specialization, or its enhanced advantage for parties living in different regions and differing in natural resources and culture. And no one holds that the facts are altered by political boundary lines. All that can really be said about the issue, in economic terms of the effective use of resources, is covered by Adam Smith's example of wine-growing in Scotland, or more pointedly by Bastiat's petition of the candle-makers for legal prohibition of windows in houses, to exclude the destructive competition of cheap light from the sun. But such witticisms would never have been thought of unless suggested by the stupidity of actual discussion and policy. The problem here is less intellectual than the moral one of getting people to use common knowledge and ordinary gumption. I think it is not primarily a moral problem in the more usual view, of getting men to prefer the social interest to private gain. The protectionist is honest enough, as honesty goes, though the capacity for honestly confusing the two aims is a leading trait of human nature. (It is needless to explain here that in this case the private interest itself is largely an illusion.)

However, the other side of the question is equally important. Realities, including some which are unchangeable or even ought not to be changed, afford sound reasons for political interference with the "natural" course of foreign trade, in response to the economic interests of individuals. But men do not advocate and vote for protection on these grounds, and they rarely justify the measures adopted. On the other hand, again, we never get tariff laws which would actually offset the difference in cost of production at home and abroad, to say nothing of the principle that what one party gains in an exchange the other must lose, both of which principles are also widely believed and professed. Moreover, yet again, the chief intellectual merit in much of our classical exposition of the advantages of trade is the ingenuity of its confusion and error. In short, as I see it, the main problem of political-economic education centers in the role of general principles, or theory. Such principles never solve any concrete problems; yet they are indispensable for analysis. Valid principles can be cited on both sides of any question, and even the same principle, if it is sufficiently general and abstract. Witness the appeal to freedom in support of antithetical policies—indeed of nearly any policy which anyone cares to advocate.

A rational, common-sense approach to the subject matter of political economy begins with the fact that the economic problem for any individual or group is to make the best of what it has, through comparison,

selection, and combination of competing alternative ends and procedures in the use of means. All practical problems arise out of conflicts of interest and differences of opinion. Economic problems arise out of conflicts due to limitation of resources in relation to total needs or wants, and these are social problems when the ends are those of different people. But human nature is clearly averse to such rational comparison. Men seize on particular aims or courses of action and treat them as absolute. Our whole moral tradition, sanctioned by our religious tradition, stresses disdain for the counting of costs. It is anti-intellectual; it teaches that if the heart is right, in relation to emotional or transcendental values, all concrete problems will be solved automatically. In this connection, it is the failure of men's professions to carry over into practical thinking and action which saves them from disaster instead of causing it. Even "scientific" economics has slowly and as yet imperfectly come around to the comparative point of view, to recognition that the only cost which makes sense is a sacrificed alternative. Economists "of the cloth" must concede that progress in this regard has met with ingenious obstruction from the profession itself, and the doctrine of "real" or absolute cost probably still predominates in elementary instruction.

Social action is a matter of achieving desirable social changes and avoiding changes which are undesirable. In our own culture, most of the immediate and acute issues arise in connection with the terms of economic association, co-operation, or organization, though essentially similar problems arise in play and other types of associative life. An intelligent approach to economic problems must obviously begin with understanding the situation which it is proposed to change, including the possibilities, methods, and probable costs of change. The objective is to show what changes are at all worth their cost, and which are best in relation to the cost. This means, first of all, understanding the "enterprise economy." But actual discussion has always been saturated with propaganda. In the early classical treatises, it was propaganda for the liberation from social control, while of late it has swung in the opposite direction. The first requirement is to get ethical and political, as well as merely sentimental and romantic, presuppositions out of social science. This task encounters a real and serious difficulty. In dealing with phenomena of life, even in biology, description must run largely in functional terms of how the organic process is kept going, and even of the adaptive modification of structure and function for better performance.

This applies, a fortiori, and in greatly enhanced degree, to the treatment of human phenomena, social and individual, where conscious purpose cannot be ignored. But functional explanation smacks of justifica-

tion or apologetic. On the human scene, moreover, apologetic is justified up to a point. What is, must be considered good, until something attainable and enough better ideally to be worth the cost of change is in view. The abstractly ideal may be the worst enemy of attainable good; in a strictly practical sense, calling a situation hopeless amounts to calling it ideal. But human nature inclines to one of two equally pernicious extremes, either sanctifying what is against all change, or abolishing without serious reflection about replacement, to say nothing of replacement by something better.

In practical thinking, principles are significant in two ways. First, as an instructional device, they shorten the process of "acculturation" of the young. And second, thinking in terms of principles is essential for rational change, though, to repeat, principles alone never solve real problems.

Analysis of any subject matter employs a hierarchical series of principles presenting a descending order of generality and scope of application. Compte's classification of the sciences gives the general picture, and the relation between physical mechanics and engineering is a sound analogy if not pushed too far. In the latter field, the first step is to formulate the universal conservation principles—mass, momentum, and energy, quantitatively defined in primary units of space, force, and time. (Relativity refinements are not in point here.) Such principles convey little concrete information to such a practitioner as a builder of automobiles, and that little is chiefly negative—things not to try to do. General physics has the same claim as economics to be called a "dismal science." Yet this negative information is vitally important. And further, general concepts are positively essential for stating problems in terms in which they can be solved. The principles of theoretical mechanics are directly contrary to the facts for most problems of action. They abstract from friction, while our human control of energy is finally directed to overcoming friction—including the activities of our own bodies. In practice, the theoretical relation between the general and the particular is reversed; the builder's main problem is to apply energy in driving a car against frictional resistance, with acceleration and deceleration against inertia as exceptional cases. Even in mechanics, human nature does not take naturally to sound analysis; perpetual motion is the problem which appeals to the tyro, and notably to the ingenious tyro; it is by no means the dolts who waste time and resources on such schemes.

Similarly, economics must begin with principles that are abstract and unrealistic, such as perfectly economic behavior of an individual and the perfect market, and stationary and moving equilibrium. Even the use of money is a consequence of imperfection, uncertainty, speculation,

and must be excluded at the most general level of theory. But the ideal barter economy is no farther from reality than theoretical mechanics; in fact, as it would be easy to show, both involve logical contradictions. Yet abstract economic principles are universally valid, however society is organized, even without formal exchange and markets. The one necessary condition is conflicting ends, for individuals and between individuals, requiring a twofold allocation of means. Sound general theory excludes unemployment of resources, when both terms are correctly defined. As in engineering, only confusion will result from interchanging general and special cases to correspond with empirical facts and interests, as the "Keynesites" propose. The theory of equilibrium, unrealistic as it is, must precede the study of disequilibrium. And I must add that the treatment of disequilibrium and unemployment is merely confused by using such "gobs of language" as "liquidity preference" and "propensity to consume" in place of talking about what one is really talking about; namely, speculative hoarding and dishoarding and their causes and consequences. By the same token, perfect competition must be studied before monopoly of various degrees and kinds.

The relation between general or abstract and empirically more realistic theory runs into the problem of application. The latter is the political problem—the role of the state in economic life. All economic activity takes place in a framework of "institutions," partly of natural growth, partly formed by deliberate law making. These define the given conditions of market behavior, and also perform many essential functions, beginning but by no means ending with policing markets against force and fraud. These facts do not enter into sound general analysis; they merely set the main educational problem, since they are "caviar" both to the "million" and to many professional students.

The activity of the state takes two main forms. It provides an alternative mode of organization, partly independent of the market system, and it imposes various regulations upon individual market behavior. Both markets and the two forms of political action will always exist. Apart from the theoretical similarity of all mutual relations to formal exchange, there has been no society without markets, more or less free, at least since a low stage of savagery; no socialist has proposed their abolition, and no totalitarian regime has attempted it. Politico-economic problems relate to a mixed system of organization, comprising the three elements, free, regulated, and public enterprise, and their study is a joint task for the sciences of economics and government. Further, both of these sciences must use data from other branches of knowledge, from moral philosophy "downward" through the social disciplines, psychology, and biology to technology and physical science. A main problem of education is to get the public and its politicians, administrators,

and various experts, to look objectively at the nature and interrelation of the three factors in the economic organization as a whole, and to see what is patently there.

Market competition is the only form of organization which can afford a large measure of freedom to the individual, as consumer or as producer. Socialists have begun to recognize this fact, that state economy can preserve freedom only by operating through a system of markets. As to regulation, there is a strong presumption against much of it, beyond simple police measures and prevention of monopoly. But there is a large place for general activities, especially in such fields as money, and also for the conduct of enterprise by public bodies, where it is not feasible to make competition effective. Of course (though it may be improper to say it), individual freedom and prevention of monopoly exclude large-scale collective bargaining. This is merely a seductive name for bilateral monopoly (monopoly and monopsony in current jargon) and means either adjudication of conflicts in terms of power, or deadlock and stoppage, usually injuring outside people more than the immediate parties to the dispute.

In a mixed economy, the difference between public and private enterprise is far less than is commonly assumed. On the one hand, the large productive units required by modern technology are (entirely regardless of their internal organization) much like the government; and on the other hand, public enterprises must compete with private in the purchase of productive services, and more or less in the sale of products, even as monopolies. (That they insist on monopoly status is highly significant, but the point cannot be developed here.) One main lesson of our war experience—specifically the rise in the production index (as far as it tells the truth)—is that the costs of freedom are high in terms of theoretically possible efficiency, and other theoretical losses are also involved. There is great danger that the public will misread this lesson, especially that it will greatly exaggerate the likelihood that both freedom and other values which conflict with freedom would in fact be realized under political planning and administration. One task of general education which tends to fall on economics is to make people realize that any one value must be had at some sacrifice of others; hence that we must be content—though not satisfied—with possibility and reasonable progress. The compromise is always a matter of judgment, not of fact or rule. The tendency to make impossible demands is of course largely due to the organization of special-interest groups, employing paid spokesmen, who inevitably become agitators and makers of promises impossible to fulfill.

Only a few remarks can be offered on the specific problem of cooperation between economics and politics or government as sciences,

and between these and other disciplines involved in describing and explaining the structure and operation of the threefold politico-economic order. Neither of our two disciplines deals at all with either ultimate factual data or the ultimate ideals which must guide intelligent action. It is difficult, even analytically, to distinguish between the political and the economic and still other aspects of the mixed organization and its problems which must be understood merely to predict how any proposed measure will work. Discussion of the problems of monopoly and unemployment, already mentioned, would illustrate the difficulty of intellectual division of labor and co-operation, but that discussion cannot be undertaken here.

The public seems relatively willing to leave technical problems of legislation to specialists, holding them responsible for results; but in practice the specialists are chiefly lawyers, trained from a private professional point of view. Neither political scientists nor economists are highly esteemed as advisers by the public. In economics in particular, this is no doubt partly because what attracts general attention is not the scientific work, theoretical or empirical, but moral and political speculation and preaching. Where economists are agreed, as illustrated by protectionism—and I will add a national legislative minimum wage—the situation is summed up in the adage that free traders win the debates but protectionists win the elections. On the whole, the educational task in political science is more largely the training of experts; in economics, more largely raising the general level of public understanding. Both the economist and the political scientist must expect to work for, and take orders from, a third species, described by Adam Smith as "that insidious and crafty animal vulgarly called a statesman or politician." It would surely be helpful if the two groups could learn each to understand the language of the other, and the elements of the other discipline, so as to work together intelligently; but this consummation would presuppose more unity and objectivity than now exist within the disciplines themselves.

Another difference between the sciences of economics and government pertains to method. Political science proceeds chiefly by historical induction, making relatively little use of general axioms, while in economics the balance rightly inclines the other way. Neither type of knowledge gives very full or reliable answers to concrete questions of prediction or control. We have already commented, though very inadequately, on the practical limitations of abstract economic principles; statistics may carry us further, but still not very far. It should be emphasized that the concept of economic rationality as efficiency in the use of given means to achieve given individual or group ends excludes a large part of the purposive life of men as social beings—the ideal as

well as the actual. My economist colleague on this program, Professor Clark, has somewhere pointedly commented on the nature of dispassionate rationality as itself an irrational passion. The real problems of social economy must in particular be understood in the light of the nature of man as a playing as well as a working animal and that of his workaday life as a competitive game or sport as well as co-operation for the sake of increased efficiency. And fellowship and other social interests demand consideration.

Limitations are fully as important in political science as in economics, particularly from the standpoint of education. Because reliable prediction, in terms of scientific laws, is impossible, because judgment is more important than rules, the way is open for the ignorant and romantic, the wish-thinkers, to picture political measures as working out in any way they feel to be desirable. One of the most vital needs in the education of the citizen is a fair knowledge of the possibilities and limitations of democratic political machinery—of government by law, based on discussion, and responsible administration. Electorates educated in and by democracy tend to combine lack of respect for "politicians" with the belief that elected officials will satisfy any craving by fiat, if only the right pressure is brought to bear. If we are to keep our liberties, preserve peace, and make orderly progress, political science must —I do not know whether it can or not—teach the people, as well as specialists, the major realities of human behavior in relations of power and obedience, and must give them realistic notions as to how many problems, and of what degree of difficulty, can be solved at the same time by group deliberation, and at what speed.

The most serious popular fallacies are due to a combination of economic and political ignorance and bias. "The government" is supposed not merely to miraculously multiply loaves and fishes and so distribute any amount more than is produced, but to defy the laws of arithmetic by making everybody better off in comparison with, and at the expense of, everybody else; it is asked to raise all selling prices while holding down if not reducing the same prices for the buyers. Many political scientists teach their students to view politics as a struggle for power rather than a mechanism of co-operation. In political economy, we are up against the problem of educating people to the right use of concepts and principles, in a field where the results of analysis can be applied to the problems to which they are relevant only if the bulk of the people either understand them or will recognize and follow specialists who do. The difficulty, to repeat, is not primarily intellectual; the failure to understand both principles and their limitations is due more to prejudice, either crude self-interest or naive reformist theories, the latter probably the worse corruption of the two.

In conclusion: The first step toward better co-operation among the disciplines which deal with different aspects of social action must be their development separately, as sciences. Only on this foundation can their results be combined intelligently. In particular, the social sciences must be purified from presuppositions, especially from romantic ethics; and ethics must be developed as an independent critical discipline, not a science in the accepted meaning of the English word. Of the role of the specialist or expert in ethics—specifically social ethics or political philosophy—we can only note that it is at best an especially difficult problem, and is made vastly more difficult through the traditional pre-emption of this role by spokesmen for organized religion, always a special-interest and pressure group. Currently, traditional religion is being replaced by ideology—also organized and quite as dogmatic and intolerant and power seeking—and no improvement, if you ask me!

All the special disciplines must confront in various ways and degrees four tasks: to raise the general level of public intelligence; to raise their own level through research and critical thinking; to train specialists for active and co-operative participation in the political process; and to inculcate a right attitude of mutual understanding and respect in the public and in the functional specialists. Free society requires intellectual and moral leadership, but this merely defines the problem and locates the difficulty. Democratic leadership must keep the right distance in advance of the masses, and in the right direction—and not too many directions—and must lead by education, not dictation. The only guarantee of this relation is that leaders shall be constantly forced by an educated clientele to follow more than they lead.

# POLITICAL SCIENCE, ECONOMICS, AND PUBLIC POLICY

*By* William Anderson
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Our two Associations are here in joint session for the first time in many years, and no doubt there are many here who hope that this is but one sign of our drawing closer together in spirit and in thought. It is one of the disadvantages of the size to which each Association has grown that joint meetings are so difficult to arrange. It was certainly a misfortune during the recent years of depression, recovery, and entry into a second World War, that we did not meet together more often to exchange views on questions that deeply concern our respective fields of study. We cannot easily recover any ground that we lost during our years of separate meetings, but we can at least endeavor to determine where we stand today. If we can even get our bearings with some accuracy we can undoubtedly, in the years of reconstruction that lie ahead, do much to perfect our knowledge of our respective disciplines and to throw light on public policies. These are our joint and several responsibilities. But first we need to understand each other.

Social scientists engage in the study from different points of view of the relations that exist among men. These relations are of many kinds, such as the relations of buyer and seller, employer and employee, teacher and student, father and son, governors and governed. As we see them today, human relations are so numerous, varied, and intertwined that an absolute separation or disentangling of them is simply impossible. We follow the relationship of buyer and seller, for example, only a short way before we run into laws of property and contract, and governmental regulations of production, quality, price, and honest measure. Every type of human relationship in modern society presents a similar complexity. As a result it cannot be said that economists have the exclusive right to study the relations of buyer and seller or of employer and employee, or that political scientists have a monopolistic right to study the relations between governors and governed. All a political scientist needs to do to see how we are bound to each other by the very nature of our subject matter is to examine any standard textbook in economics. In it he will see topic after topic that is dealt with also in political science. Similarly an economist needs only to examine a textbook, say, in American government to find many subjects that are treated also in economics. Government regulation of business, taxation, tariffs, labor, and agriculture are among the common topics that lie in the broad neutral zone between the two disciplines.

It follows, therefore, or so it seems to me, that however separate may be our professional associations and our departments in colleges and

universities, we cannot in fact exist wholly apart from each other. H. G. Wells spoke somewhere of the "intimate detachment" that characterizes the relations of husband and wife. Intimate detachment is a good phrase, and one that applies also to the relations of economists and political scientists. We can organize separately, try to live in separate houses, and stand off and criticize each other without end, but a real divorce is unthinkable between our two disciplines. We perform complementary functions and we need each other's services at many points. It is only through more effective co-operation and better understanding of each other that we can truly make better progress.

But if divorce is impossible and has never really taken place, then remarriage is also out of the question. There has been, of late, some deploring of our relative separateness, and some talk of developing a "new political economy." The idea seems to be that, because of increased intervention by government in the economic world, the differences between economics and political science are going to disappear and that a real fusion of subject matter is going to take place. To me this seems to be equally unlikely. In purpose, in approach, and in methods of analysis, and to a considerable extent in their subject matter, the two disciplines are distinctly different. A certain degree of detachment and freedom is necessary for both parties, so that each may more thoroughly perform its own true functions. That more intimacy and more co-operation in certain respects are also desirable it is my purpose to indicate.

The differences between economics and politics were early recognized by the Greeks. The educated men and citizens of Athens had a great contempt for trade and industry. They wrote learnedly and at great length about politics, but as to economics, when they did not ignore it entirely they made it almost wholly subordinate to politics. Of course the Greek city-state, even when supposedly democratic, approached a totalitarian concept, since the state was free to control every social relation. In Greek writings, therefore, politics prevailed almost completely over economics.

Skipping over many long centuries we come to a time when the tables were at least partly turned. The study of economics, first encouraged in certain royal households as an aid to state management, became an independent discipline through various developments too long and complex to be recounted here. At the hands of Adam Smith economics obtained substantial stature as a separate discipline. It was soon called "political economy," it is true, but this in no sense meant that it was a study of government or politics as such. It dealt with the economic problems of nations or peoples, and not merely with the economics of government. The followers of Adam Smith carried the specialization of

economics as distinguished from politics very far indeed. Accepting the notion that natural and immutable laws prevail in the production and distribution of wealth, they warned against state interference in the economic sphere. Except for a very limited range of functions, including national defense and law enforcement, every presumption was against the state. Economic laws were natural and beneficial; political actions were by contrast artificial and dangerous.

Taking his cue from the classical economists, but giving reasons that they mainly disapproved, Karl Marx preached the complete sovereignty of economics over politics. His monistic interpretation of history, in which the changing modes of production of goods determine all political and social structure, made it possible for him to say that the capitalist state is only a certain class structure of society, and that the government is only a committee of the capitalist class to oppress the proletariat. Legislatures, executives, and courts, the civil service, the police, and the army, are thus set down as mere tools of the capitalists. Having in this way contemptuously dismissed the whole subject of political science as subordinate and unworthy of serious consideration, he and his followers turned to the only study that was important; namely, economics. It is one of the major defects of the whole Marxian analysis that it gives so little attention to politics and administration.

In becoming an independent study, economics made some of the exaggerated claims to an ability to stand alone, and even to superiority over others, that nations with newly-won independence often show. The classical economists did this rather modestly; yet they attempted decisively to put politics into a subordinate place, accepting it as a desirable aid to economics only if it kept within a narrow and subordinate sphere. The Marxians did it with much swaggering and with high claims to having made a great scientific discovery. Unfortunately for them, the same dialectical process for which they made such sweeping claims in the name of science, did not teach them that they were pushing their case too far. To put economics above politics they swung the pendulum so far that it was bound to swing back. Time and circumstances are now having their revenge. The very country in which Marxism was first given a real demonstration, revealed the inescapability of politics and government, while throughout the rest of the world the political authorities have had to take firmer hold of the economic system to save the people from stark ruin. The scientific distinction between economics and politics remains as valid as ever, but in practice the two are now so inextricably interlocked that a clear-cut separation is impossible.

Under such conditions it is particularly misleading to assert the supremacy of either one, or to claim that one is basic to the other. It is just as true to speak of "the political basis of economics" as to talk

of "the economic basis of politics." It is just as true for the simple reason that neither one is true. To speak of anything in the social sciences as basic or fundamental to anything else is misleading. Such language is representative of the deceptive metaphors taken over from the physical and biological sciences and applied with too little thought to those intangibles that we call human relations. A building usually has a foundation, but politics is not a building erected on the foundation of economics, or vice versa. At best our vocabulary in the social sciences is too largely taken from the physical sciences, and we need to watch ourselves carefully to prevent ill-chosen words from making us see what is not there. We can apprehend interrelations between business and government, and between the studies of economics and politics. Economic activities have not only economic but also political, moral, and social consequences, while political actions also affect other aspects of social life—economic, moral, social, and religious. We can assert that men in society are interdependent and that their actions have consequences beyond what was planned or intended; but we cannot prove the supremacy of one type of action over other types under any and all conditions.

Of course the Marxists carried the pretended sovereignty of economics entirely too far in still other directions. Moral principles went out of the window, condemned by the contemptuous phrase bourgeois morals, while religion was discarded as the opiate of the people. Adam Smith, that old professor of moral philosophy, would, of course, have been horrified by this, and shocked to know that he helped to open the mind of any man to such destructive thoughts. And, in truth, Smith cannot be blamed for the iconoclasm of the Marxists. Nevertheless if one presses too hard the doctrine that all social activity must be subjected to the sovereign rule of cost-and-price economics, then all religious, moral, social, political, and even biological considerations must give way before it. To be sure there is always the promising though indefinable distinction between the long-run and short-run effects of economic action to give the economist a way out. The labor of children may provide the cheapest means of immediate production for a particular producer, but it can be rejected on purely economic grounds (without going into such maudlin considerations as morals might suggest) because of its supposed higher cost in the long run to the community as a whole.

The political scientist is inclined to reject such an approach because he does not accept the dictatorship of purely economic considerations. It is one of his functions to try, in any situation, to balance against each other the various factors that affect individual and public welfare. Having made his analysis from all the available data and arguments he

is inclined to stress that factor or group of factors which, in a given case, seem to him the most important. National security, international order, individual liberty, a moral life, religious freedom, popular control of government, to give a few examples, are to him worthy to be placed alongside of economic cost and often even to be put ahead of it. He is not able, as a rule, to present demand and supply curves, tables of statistics, or mathematical formulae to prove his point. Hence his argument lacks some of the apparent accuracy of economic analysis. This is not to admit that his case when fully worked out is any the less sound, and certainly when well done it is based upon a broader range of data.

Nevertheless I think my brethren and I in the political science profession have in recent decades not made adequate use of the findings and analyses of the economists. We have studied the law, the procedures, and the administrative organization and problems in such a field, say, as social security or child labor, agricultural programs or the TVA, and have neglected to utilize fully the available economic literature. We have not been sufficiently mindful of costs or of economic consequences. We have either been unaware of or we have ignored or mistrusted the economists, as they in turn have been somewhat unaware of or have ignored or mistrusted us. The results have not been good, and in some highly important fields such as national budget making and fiscal policy our neglect of economic considerations can be most serious to ourselves and to the public.

Whether economists have been equally neglectful of political considations and of the writings of political scientists I am not prepared to say. The few books in economics that I have examined recently lead me to suspect that this may be so, but my evidence is insufficient. On both sides we are inclined to be clannish, to read the books and periodicals in only our own field, and to attend the meetings of our fellow specialists. Thus we come to develop and to intensify our biases rather than to broaden our scope and vision.

It has been suggested that there are inherent differences between economists and political scientists that necessarily produce lack of understanding, that political scientists tend to be collectivists and economists to be individualists. Why it is that one man, starting as a young student, turns in the direction of economics and another toward political science, I suppose nobody knows. Maybe there is something in the all-potent genes that the biologists talk about, or perhaps there is some undiscovered difference in our hormones or our body chemistry or anatomy. I can only say that I doubt this very much. There is not enough difference between us to suggest any radical physiological disparities. Furthermore there are many cases of men who, like John

Stuart Mill, have done respectable work in both fields, and still more whose major academic concentration has been in one field and whose minor in the other. Environmental factors—the things we observed in our youth, the books we read, the teachers we had, and the educational opportunities afforded us—were probably more important than biological differences in the choices that we made.

Whatever may be the facts as to our individual differences, it is, I think, incorrect to assert that our scientific disciplines as such are by nature biased, the one toward collectivism, the other toward individualism. That the men in our respective professions show somewhat divergent tendencies of this nature has already been admitted. I for one would attribute this more to the deficiencies in our education and to the influence of our materials upon us than to any other cause. That few of us either as undergraduate or graduate students get a well-balanced program of studies in both fields is a fact known to all. The high concentration of our studies as graduate students is especially narrowing, and our subsequent research and teaching only accentuate our differences. We become familiar with our own particular materials and field of work and confident in our mastery thereof, but we lose touch with other studies of our earlier days and soon develop fears and suspicions concerning them. We are obviously conditioned by what we do. It requires an unusual mind and very hard work for any man to keep abreast of the developments in several fields. Very few are able to do it. Thus, as individuals, we drift apart into our several specialties and unconsciously develop biases and limitations. At the same time our sciences as such obviously remain neutral on such great issues of policy as collectivism versus individualism.

As men and as individuals I take it that economists and political scientists are interested in promoting the same general cause; namely, the maximum of human welfare, now and in the future. Their differences, which are individual differences and not truly group differences, relate to means and methods, and these result, as I have tried to indicate, from the confining effect of their particular studies.

In his little book on *Karl Marx's Capital,* A. D. Lindsay presents the contrast between individualism and collectivism in a simple but unusual way. While trying to explain the determinism of Karl Marx he says that "there is a necessary connexion between unrestricted individual freedom and collective determinism." When everyone is free to do just what he desires, conditions are soon created that no one has willed but that prevent everyone from achieving what he desires. If every man is free to kill all the game that he wishes, a condition soon prevails in which there is no game for anyone. If every coal mine owner is free to produce coal without limit, we soon have a sick industry in

which there is great waste of resources, wages are depressed, and very few make substantial profits. If everyone were free to drive upon the highways without any rules as to speed, turns, left- or right-hand driving, or size or type of vehicle, no one could get maximum satisfaction out of the roads and the traffic snarls in certain places would be wholly unbearable.

While political scientists are particularly impressed by this proposition, it is so simple and logical that I am sure that all intelligent men are ready to accept it. It expresses in one sentence the two principles of the interdependence of men, and of their common or mutual dependence upon the available resources. It provides an irrefutable argument for the necessity of co-operative activity whether through the compulsions of government or through less coercive and more voluntary methods. It is in no sense anti-individualistic, but it does recognize that there are necessary limits to individual action. More than that it expresses the close connection between what individuals do and what groups have to do.

What men and groups do, in turn, is always conditioned by the existing social arrangements and the available resources. At this point all the social sciences have a common concern; namely, to understand the conditions necessary for human welfare and for the kind of human relations that we, not as scientists but as human beings, consider desirable. What are the conditions necessary to preserve democratic institutions, to ensure a system of free enterprise, to promote individual freedom, and guarantee social security? Do economic cataclysms like widespread unemployment undermine democracy? Are freedom of speech and press as necessary for a regime of private enterprise as for the maintenance of popular government? Are measures for social security really compatible with individual freedom and democracy? These are but a few of many questions that should concern all social scientists because of the observable interaction of all environmental and social conditions upon each other.

In certain cases covered by Lindsay's general principle, political scientists and economists have an interest that exceeds that of other disciplines such as sociology. The cases that I have in mind are primarily in the broad field of public policy and the functions and activities of government—the area in which the two disciplines most distinctly overlap. I have already mentioned such standard topics as government regulation of business, taxation, tariffs, labor, and agriculture. The postwar years are likely to bring about a surprising number of new proposals for public action, local, national, and international. These will range all the way from the well-considered proposals of able and responsible men to the vain imaginings of impractical propagandists.

They will include propositions to improve and expand social security laws and health measures, both private and public; to stimulate urban redevelopment and housing; to establish great development projects like the TVA on a national and even international scale; to push forward the progress of backward areas and peoples with a view to their ultimate independence; to administer a series of economic, health, and welfare measures on an international scale; to establish international airways and highways for mail, passengers, and freight on a scale hitherto unknown. The proposals for postwar reconversion of industry and government and the re-employment of men will alone tax our best abilities for years to come.

Not one of these proposals is simply economic or merely political. Each one raises questions of economic practicability and the distribution of costs, and each one calls for consideration of its governmental feasibility and the best methods of administering it. These questions cannot be analyzed in the abstract or without a consideration of other major aspects. In short, every proposal needs to be taken as a totality and examined by competent experts from every point of view. That will mean in most cases some specialists besides economists and political scientists, but in general I think these two groups are the ones most concerned.

It is my suggestion, therefore, that major questions of public policy be taken as the subject matter for a new type of investigation and teaching by our two disciplines acting jointly. In colleges and universities, and especially in the graduate schools, let us experiment with some joint seminars, in which faculty members and students from both departments will participate. Let these be considered a very serious part of our work so that our students will benefit from the give and take of frank and earnest discussion of public policy questions. Let us require our students, and especially those who aim to go into teaching or into public administration, to prepare reports on topics as a whole, including their economic, political, and administrative phases. Perhaps in this way we can begin to broaden our teaching and also to provide the government with administrators and economists who know some important matter from all angles. Students of political science and public administration will come to learn more about economic subject matter and modes of economic analysis, while students of economics will gain some familiarity with political and administrative problems. In each case they may elect to take more of the fundamental courses in the other department, a consummation that is, I believe, greatly to be desired.

The collaboration of the two disciplines might also be experimented with in other ways. Joint conferences on major policy questions could be held both at and between our annual meetings together. Textbooks

and histories of thought in the field might in some cases be made the joint products of one man from each discipline. Co-operative or joint lecture courses in the universities on such subjects as public finance or government regulation of business might also prove interesting and instructive to our students as well as to ourselves.

If we were to proceed by some such steps to break down the walls that separate us and to cultivate together that part of our garden where we have truly common interests, I believe that we would begin to get some new insights. On the general question of individualism versus collectivism we should probably be found to be very close together but with significant differences of emphasis. While we would find our common interests both large and increasing, it would also become clear that each discipline has large fields of work that are distinctly its own. In the areas that are common to both we would soon turn up such challenging topics for comparative study as bureaucracy in business and in government; large- and small-scale units and operations; communications and other relations between central offices and the forces in the field. Each side might see more clearly that while political science has its unsolved problem of how to reconcile individual liberty with powerful, large-scale active government, economics has its parallel problem of how to organize industry so as to procure the benefits of large-scale production and still preserve the opportunity for individuals and small-scale enterprise to compete successfully in the market. We in political science might even come to see the full import of such concepts as monopolistic competition and equilibrium price. If we could do that, and I cannot promise that we will, would it be too much to expect economists to learn that politics is as natural and as necessary an activity of men as economics itself?

# PUBLIC ADMINISTRATION OF TRANSPORTATION UNDER WAR CONDITIONS

*By* Joseph B. Eastman
*Office of Defense Transportation*

What I shall say to you today will be along lines somewhat different from those that I usually follow in talking of wartime transportation. In general, the audience which I am now addressing is interested, I assume, not so much in matters of practical operation and shipping, but in the plan and methods which have been employed by the government in this World War, as a matter of administration, in seeing to it that domestic transportation service is adequate for the war effort. Of the extraordinarily important part which domestic transportation plays in modern warfare, I am sure that you do not need to be informed.

A very common reaction at present is to draw a violent contrast between government operation of the railroads in the last World War, which is stigmatized as a horrible failure, and private operation of the railroads and all other forms of transportation in this war, which is painted as a brilliant success. I do not wholly endorse this comparison, at least the first part, and it happens that in both instances I am well acquainted with the facts from close personal observation.

The railroads were taken over by the government in the last World War for two principal reasons. One was that neither the railroads nor those in charge of military operations and war production were well prepared or organized for the traffic stresses and strains which the war brought and which were new, strange in pattern, and very severe in their impact. Confusion and congestion resulted. Centralized direction and co-ordination were necessary, and after a little unsuccessful experimenting with a Railroad War Board, made up of railroad executives, the conclusion was reached that only the supreme authority of the government could bring quick improvement.

The other reason, which was very important but is commonly overlooked, was that prices had risen so steeply that a large wage increase was deemed inevitable, and in the light of these conditions it was equally clear that private operation, to be successful, would require a large increase in rates and fares. In the immediately preceding years, successive attempts to increase rates had precipitated such bitter and long-drawn-out contests before the Interstate Commerce Commission, with what the railroads and the financial world deemed to be inadequate results, that there was an indisposition to try this route again for greater stakes amid the exigencies of war. You will recall that upon the taking over of the properties, one of the early things that the government did, by fiat and without preliminary hearings, was to increase rates and

fares heavily. You will recall, also, that the telephone and telegraph properties were taken over by the government, not because of any failure in operation, but to make a similar speedy increase in rates.

Government operation of the railroads in the last World War was not, in my opinion, the failure that it is commonly reputed to have been. Of course the United States Railroad Administration had to be improvised overnight and the organization and administration were imperfect in many respects. It takes time to perfect so vast an undertaking, and the war was over within about ten months of the inception of government operation. In the ensuing months, with uncertainty only as to the time of return to private operation, there was little opportunity to improve the setup. However, the United States Railroad Administration was in fact manned very largely by men chosen from the cream of the private railroad executive force, and it was successful in providing adequate service for war operations. Walker D. Hines, the second Director General of Railroads, in his *War History of American Railroads,* gave a dispassionate, and to my mind accurate, appraisal of accomplishments and defects.

Much is made of the fact that the government incurred a large deficit, amounting to a little more than one billion dollars, after paying to the owners compensation for the use of their railroad properties during its twenty-six months of federal control. This could have been avoided by a further increase in rates, which was instead postponed until after the return of the properties to their owners. Extraordinarily large increases were then made. In my judgment, the government could have prevented a deficit by lesser increases. In the six months following the resumption of private management, the government guaranteed the owners the same return that they had received during federal control. This guarantee cost the government considerably more in proportion than the deficit in the period of public operation.

Turning to the present war, the policy pursued has been to maintain private management and operation of domestic transportation. The fact that the railroads were recently in the hands of the Army was not an abandonment of that policy. This step was taken, not because of any failure in the policy, but to ensure continued operation of the railroads in the face of a threatened strike. This episode has proved to be, as I felt sure would be so, no more than a temporary interlude. Moreover, the management was not in fact changed.

Whereas circumstances forced a resort to government operation in the last World War, circumstances this time permitted and counseled adherence to private operation. It is now more than two years since Pearl Harbor, but our war production began long before. Railroad traffic increased steadily and rapidly in both 1940 and 1941. Profiting

by experience in the last World War, the railroads and the great shipping agencies of the government, particularly the Army, were prepared. They were well organized, centrally and otherwise, and knew what to do and what to avoid. The emergency powers of the Interstate Commerce Commission had been materially enlarged and improved. In other addresses I have gone more fully into these matters.

It is important to bear in mind, also, that although railroad cars and locomotives were considerably less in number when the present emergency began than at the time of the last World War, eight billions of dollars had been spent in the intervening period on improvement of the properties; the cars and locomotives were on the average of greater capacity and better quality; and much short-haul and some long-haul freight and passenger traffic had gone to the trucks, the buses, and the private automobiles. These changes had largely increased the speed of equipment circulation, so that a given number of cars and locomotives were able to do materially more work than in the earlier period. While, also, the railroads had gone through a long and severe period of financial depression, the fact that many of the weaker roads had gone into bankruptcy had, paradoxical as it may seem, enabled them greatly to improve the condition of their physical properties.

Early in 1940, the President created an Advisory Commission to the Council of National Defense, and appointed on that Commission Ralph Budd, president of the Chicago, Burlington and Quincy Railroad Company, to represent transportation. Mr. Budd had no definite authority or powers, but he did much, in counsel with the railroads, the other types of carriers, and the government agencies, to protect the situation for the future. Later on, the President deemed it necessary to formalize and extend government surveillance over domestic transportation in the emergency, and at length he did this by the creation, through an Executive Order, of the Office of Defense Transportation, of which I am director. While the order was not signed until December 18, 1941, after the declaration of war, it was prepared some considerable time before, which accounts for the name, Office of Defense Transportation, instead of Office of War Transportation.

Before I discuss the authority and policies of the Office of Defense Transportation, I think it well to point out two things. In the first place, its jurisdiction is by no means confined to the railroads but extends over all of domestic transportation, including the water carriers, the trucks, buses and private automobiles, the local transit systems, the pipe lines, and the air carriers, and to some extent over storage facilities. Being derived in large part from the war power of the President and Commander-in-Chief, it also extends to intrastate as well as interstate operations and to private as well as common-carrier or contract-carrier operations.

In the second place, certain matters which are of vital importance to domestic transportation are not within the ultimate jurisdiction of the Office of Defense Transportation. The War Production Board, through its control over critical materials, has the final say on the expansion, replacement, and maintenance of facilities, except that when it comes to rubber tires, the Rubber Director is the dominant factor. The War Manpower Commission is responsible for the supply of labor, but the decisions of the War Labor Board and fact-finding boards of the National Mediation Board with respect to wages, subject to the approval of the Director of Economic Stabilization and possible appellate action by the President or Congress, affect this matter greatly. The Petroleum Administrator for War and the Solid Fuels Administrator for War control the supply of coal and gasoline for motive power. Authority over rates and charges rests with either the Interstate Commerce Commission, the Civil Aeronautics Board, state, or municipal regulatory authorities, or the Office of Price Administration. The latter is the agency which has immediate charge of rationing both gasoline and tires. The Interstate Commerce Commission has broad emergency powers over both railroad car service and motor carrier service. The Army and Navy are responsible for tremendous movements of property and persons, and have many and important direct relations with the carriers. Included in the domestic transportation picture to some extent are also, among others, the Department of Agriculture, the War Food Administration, the War Shipping Administration, the Office of Civilian Defense, the Civil Aeronautics Administration, the Defense Plant Corporation, and the Committee for Congested Areas. Ultimate supervisory authority is in the hands of the Office of War Mobilization, and committees of Congress are continually carrying on investigations.

In most of the matters which I have enumerated the Office of Defense Transportation plays a part, although it does not have the final word. It is, for example, the claimant agency of domestic transportation for critical materials before the War Production Board, for rubber before the Rubber Director, for gasoline before the Petroleum Administrator for War, and for coal before the Solid Fuels Administrator. It has representatives on both the War Production Board and the War Manpower Commission. It can negotiate voluntary rate adjustments with the carriers and make representations as to rates before the regulatory authorities. On wages alone it has no chips in the game whatsoever. The whole setup is, of course, far from perfect, but I do not criticize it on the ground that authority over transportation is somewhat divided. Matters such as critical materials, wages, prices, and manpower are of such general importance over the whole range of the war effort that they cannot wisely be left to individual treatment by commodities or services.

There were no close precedents for the Office of Defense Transpor-

tation. It is an anomalous institution, with authority that in some respects is none too clear. It has no power to manage or operate any form of transportation, except two little railroads, the Toledo, Peoria and Western and the American Railroad Company of Porto Rico, which were dropped in its lap as a result of labor controversies. The duty, broadly speaking, is to keep close watch on domestic transportation in connection with the war effort; to protect the interests of such transportation before other agencies of the government, particularly the War Production Board; to do everything possible to promote the maximum utilization of transportation facilities; and to this end to compel action by orders, where necessary. I have always felt that its success was dependent much less upon its powers than upon wise administration, and that its main function was one of friendly leadership in the cause of those two things which we label, not any too definitely, co-ordination and co-operation.

It may interest you to know that the railroad industry, which is well organized and in the hands chiefly of large companies, accounts for a comparatively small part of the expenditures of the Office of Defense Transportation. For two-thirds of the total the motor trucks are responsible. That form of transportation is now of very great importance in this country. It is of basic essentiality to farm and community life, and it supplies many other vital needs. No form of transportation has suffered more from war conditions or is in greater need of help and guidance. The four and a half million or so trucks, however, are in the hands of more than three million individual owners. It is impossible to do effective work with these owners without maintaining direct contact with them through a field force, and a nation-wide field force runs into money.

I shall not, in this address, discuss the many measures and methods which the Office of Defense Transportation has employed to accomplish the results desired. For present purposes it will suffice to say that, very generally, our efforts have met with wholehearted co-operation and, to date, with a high degree of success, all things considered. There has as yet been no substantial impairment of the war effort on account of any deficiencies of domestic transportation, notwithstanding highly adverse conditions. The load upon our transportation facilities, in the carriage of both property and persons, has risen far above all prior records. Early in the war we lost the benefit of our intercoastal and most of our coastwise shipping service. There has been little expansion of other facilities, and in some forms of transportation the supply of new equipment has fallen far short of necessary replacements. It has been a problem of squeezing the last ounce of use out of the facilities that we had. In the face of these difficulties our transportation agencies have, in my

opinion, turned in a superlative performance. Of course service has not been what it should be in normal times, but it has been adequate for war needs.

A most significant fact is that, quite to the contrary of what happened in the last World War, the earnings of the railroads have been extraordinarily good; and this has been true, also, of the intercity bus lines and the local transit systems, and to a lesser extent of the other forms of transportation, with the exception of many of the trucking companies. Railroad rates were increased in 1942, 6 per cent or less in the case of freight and 10 per cent in the case of passengers, to compensate for an increase of wages in 1941; but in 1943 the freight increases were removed. The passenger increases were allowed to stand, but the coach fare is still considerably below the average coach fare at the time of the last World War. Railroad earnings, however, have remained very high. I ascribe this situation, first, to the fact that we have so far been more successful in resisting inflation than in the last World War; and, second, to the fact that dense traffic combined with the close approach to maximum utilization of facilities which has been accomplished has also been productive of highly economical operation.

The greatest contributing factor to this excellent performance, I am sure, has been the circumstance that management and operation have been left in private hands. This does not mean that I am a dogmatic opponent of public operation of railroads or other public utilities. There are conditions where such operation is wise, and even where it may be the only recourse, as many countries have found, and as we found in the last World War. The choice is one which should be made after a cold-blooded appraisal of conditions, as free as possible from prejudice one way or another. In this war, however, there was no need, except for the interlude of Army occupation, for a change from private to public operation. The private managers have been put on their mettle, not only to do their part in the war effort, but also to show that private enterprise is capable of rising fully to the needs of a grave emergency, and they have responded wonderfully well. A similar spirit has imbued the shippers of the country, and their co-operation has been of a value which it is difficult to overestimate. The same has been true, except for the wage controversies, of the employees, and to a very considerable extent it has been true of the general public.

It has been my policy and pleasure to co-operate as best I could with all these parties in interest. I could see no good to be accomplished, and much to be lost, by a shift in possession and management. Any radical change is disturbing and requires a period of readjustment to the new conditions before equilibrium and morale are restored. It is always a good rule not to change what is working well, and I have never

had any doubts, since the start of the Office of Defense Transportation, that this was the sound rule to follow with respect to domestic transportation.

Before I conclude, there are some general comments upon war work which I offer for what they may be worth. Our permanent organization for war, and especially for such a war as we are now waging, has always been rudimentary. Normally our nation is organized for peace and not for war. When war comes, therefore, it is necessary to improvise suddenly much of the organization required for its conduct, and modern warfare requires a gigantic marshalling and organization of both national resources and population. Wholly new and very large administrative agencies had to be planned and created in short order. It is a wonder to me that we have done as well with these new agencies as we have done. It is hard enough to keep an old and long-established organization of large size functioning in good order. It is a herculean task to plan, man, and captain overnight great new organizations to do work of extraordinary complexity which has never been done before.

It goes without saying that there have been numerous flaws in the policies, methods, and personnel of these agencies, and stability has not been one of their outstanding characteristics. Overlapping of authority has been frequent and troublesome, and I have found plenty of it in our transportation work. In my judgment, however, the organizations have on the whole been improving steadily. Given time, they will shake down to a situation where responsibility will be more clearly defined, with a greater degree of mutual understanding and confidence and less need for frequent resort to conferences and joint committees. Yet the great and important fact is that notwithstanding these defects, the war work is being done, and my guess is that history will say that it is being done better notwithstanding its immensity, than in any of our previous wars.

The faculties of our universities and colleges have contributed much personnel to this war work. Somewhat to my surprise, I find that in my own organization there are eight Ph.D.'s. I know they are doing capable work, and in general I believe that to be true of the many others in Washington with a similar background. The chief handicap under which they are apt to labor is inexperience in dealing with the public and public representatives as a public servant, and in putting theories into practical operation. Even in mechanics, a device which seems perfect in the blueprint stage often fails to work out in actual practice, and the same is true in an even greater degree of theories of political science and economics.

The role of the government, while it will shrink after the war is over, will continue, I believe, to be considerably greater than it was before the war, and problems of tremendous scope and difficulty will be in-

volved. The government will, of course, deal imperfectly with these problems, for everything human is imperfect, and I sometimes fear that it will not even deal with them well. No doubt that is merely the pessimism of age. For what it may be worth, however, my judgment is that to deal with them well, we must have a better informed and better disciplined citizenry and public officials with a higher average of sound and strong character. Even when their aims are good, they must show less inclination to regard the end as justification for the means and more readiness to endanger their personal careers in the defense of principles. They must not regard Gallup polls and like tests of the public opinion of the moment as controlling guides, for often these only prove the need for more general enlightenment. It may be that what we need most is a renaissance of religion in some form. Certainly we all stand in great need of prayer, not only while this war endures, but thereafter.

Through the close contacts of present wartime experience, government, business, and labor leaders have learned more about and from each other than they ever knew before. Not all of it is good, but such contacts breed a mutual understanding which is immensely valuable. One thing that these leaders must surely have learned is the great degree of similarity, in broad groups of men, of the varying motives, intelligence, and emotions which control individual action. Another is that the best men in these groups must find a way of working together for the common good, if we are to make real progress in solving our problems. It is far more sensible for all of the sheep to work together against all of the goats than for composite groups of sheep and goats to war against each other.

To the development of the truth, which must prevail if society is to move forward rather than backward, you here can contribute greatly. That is the prime purpose of our institutions of learning. It is only as you pursue the truth wherever it may lead, divest your thinking of bias, cease to be the evangelist for some particular "program" or "order," cease to rationalize rather than reason, that you can effectively lead or train. Those of us who through years of experience in its service know something of the problems and difficulties of government and sense the yet greater challenge in years ahead, hope we shall not look in vain to our colleges and universities for such help.

These are thoughts which I should like to pursue at greater length, but this is neither the time nor the place. Nevertheless, I do want to leave with you this brief appeal, for the men and women who compose the Associations I now address can, if they will, exercise much influence in making possible better standards of life and improving public service. You have the necessary opportunity for study, for the development of knowledge, and for objective judgments. With that opportunity go responsibilities.

# THE STRUCTURE OF POSTWAR AMERICAN BUSINESS

## LARGE VERSUS SMALL BUSINESS AFTER THE WAR[1]

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A truly competitive economy is necessarily predicated upon the continued existence of small business enterprise. In fact, it presupposes the prevalence and dominance of such enterprises in order that no one or any group of them will exert any appreciable influence on output, price, or the market. It implies active rivalry for business and independence of action on the part of each concern in all its major operations.

To a very substantial degree, that has been the American experience until the latter part of the past century. Whatever notable deviations from this pattern have occurred were generally frowned upon and, through the common law and later through the Sherman Antitrust Act, attempts were made to curb their progress and to correct such malpractices wherever discovered.

Even up to World War II small business was numerically preponderant. But before any pertinent statistical facts are cited, attention is directed to three difficult questions, involving the meaning of the terms small and large, the line of cleavage between the two, and the unit of measurement. Conclusions reached are dependent in no small measure upon the answer to these questions.

Small business is popularly identified with the independent local merchant, just as "big" business is identified with the U. S. Steel Corporation, the Ford Motor Company, the Du Ponts, the Chryslers, the Pennsylvania Railroad Company, the Morgans, and the relatively small number of other industrial, commercial, financial, and public utility giants. These concepts, except for pointing to extremes, fail to furnish a satisfactory basis for distinguishing between the two size classes.

Even among economists and special students of the subject there is no unanimity of agreement as to what constitutes small business. The tendency, however, is to use one or more of four criteria, including the number of persons employed, asset values, net worth, and the annual volume of business. In the early studies of the subject by the U. S. Department of Commerce and by the Treasury Department, the number of workers employed has been used as the principal factor, while the Temporary National Economic Committee in its investigations of

[1] A detailed analysis of this subject is presented as a doctoral dissertation on "The Economics of Small Business Enterprise," just completed by Paul L. Brown, under the direction and supervision of the author of this paper.

the subject relied heavily upon the value of assets as a measure of business size, probably because the statistics of income issued by the Bureau of Internal Revenue make such facts readily available. But when it comes to certain types of retailing and some of the services, the annual volume of business may prove the most satisfactory standard.

Once a criterion is chosen, there remains the problem of setting the points of division between small and large businesses. This is often a matter of individual judgment, but for all practical purposes and because of the way in which many of the statistics on this matter are presented, it is suggested that the upper limits for small enterprises be set at 250 workers employed, $250,000 in value of assets used, $100,000 in net worth, or $1,000,000 in business volume, depending upon which of the criteria is utilized.

Finally, there is the question of whether the data shall be expressed in terms of establishments, plants, or other individual places of business, or in terms of companies, firms, or enterprises. In other words, is the Atlantic and Pacific Tea Company to be considered for this purpose as one organization, company, or enterprise, or as so many separate stores, warehouses, factories, etc.? Unfortunately, there is considerable confusion on this score. Practically all Bureau of the Census data are presented on the basis of single establishments, while the Social Security statistics are given for employing organizations and the data based on corporate returns filed with the Bureau of Internal Revenue are also for companies.

It is estimated that at the beginning of World War II there were in this country approximately three million business concerns.[2] A little over 90 per cent of these business concerns were small enterprises. Small business was, however, unevenly distributed throughout industry and trade. In retailing, for example, approximately 86 per cent of all establishments operated as single-line independents. Even in manufacturing as a whole, 82 per cent of all plants were operated as single-unit businesses and 98 per cent of the plants employed no more than 250 persons each. In the steel industry, however, the large mills employed an average of more than 6,000 workers and even the so-called "small" steel mills averaged around 650 workers per plant.

But numbers of establishments or companies by no means measure the relative position of small business. For example, in 1939 about 40

[2] For the year 1939 the Bureau of the Census reported a total of 3,099,799 establishments engaged in manufacturing, trade, service, construction, hotel business, amusement business, and tourist court and camp business. In addition, the Social Security Board reported the existence of 213,910 employing organizations in finance, insurance, real estate, public utilities, transportation, and mining and quarrying. The TNEC estimated that 346,617 of all establishments (in 1938) belonged to multi-unit organizations, thus making the total number of business concerns 2,967,003.

per cent of all retail business was transacted by large-scale concerns like department stores, chain stores, and mail order houses although they constituted but 7 or 8 per cent of all retail establishments; only 3 per cent of all manufacturing plants employed over one-half of all persons engaged in manufacturing; nearly 90 per cent of the variety store business was accounted for by chains; and almost all the rail transportation and the public utility business was in the hands of large concerns.

More important still is the fact that throughout this century the trend in American economic life has been in the direction of mass production, mass distribution, and generally large-scale enterprise. While at the beginning of this century small business was the dominant form of enterprise, both in numbers and volume of business, today the share of the total business volume taken by such enterprises is relatively small, especially in certain areas of our economy, and this share is rapidly shrinking. Thus, we have the phenomenon of a larger number of small businesses competing for a smaller share of the total market. The trend has truly been for small business to become smaller and smaller, and for big business to become bigger and bigger.

Big business generally manifests itself in the corporate form. Thus, the importance and growth of large enterprise can be traced through the rise of big corporations. By 1930 it was estimated that at least 78 per cent of American business wealth was in the form of corporate wealth.[3] By 1939 corporations produced no less than 92 per cent of the value of all manufactured products, compared with 87 per cent for 1919, 83 per cent for 1914, and less than 67 per cent in 1899.[4] All of the business in the communication and electric light and power fields is done by corporations, as well as 96 per cent of the mining business, 89 per cent of the transportation, and 84 per cent of the finance volume.[5]

Moreover, corporate strength tends to be highly concentrated. In 1930, the 200 largest nonbanking corporations controlled 49.2 per cent of the total assets of all nonbanking corporations, or approximately 38 per cent of all business wealth.[6] Control was even more concentrated than these figures indicate, inasmuch as a mere handful of individuals, through interlocking directorates, have been directing the policies of the 200 leviathans.

By 1933, the Twentieth Century Fund concluded that the 594 largest corporations owned 53.2 per cent of all corporate assets.[7] By 1935, one-tenth of one per cent of all corporations owned 52 per cent of total

[3] Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan Co., 1932), p. 31.
[4] 13th, 14th, and 15th Censuses of the United States.
[5] W. L. Thorp, *Hearings, TNEC*, Part 1, p. 96.
[6] Berle and Means, *op. cit.*, pp. 19-31.
[7] *Big Business: Its Growth and Its Place* (Twentieth Century Fund, Inc., 1939).

corporate assets, and less than 5 per cent of them owned 87 per cent of all such assets.[8] Finally, in 1939 there were 737 corporations with assets of 50 million dollars or over, owning no less than 55 per cent of all corporate wealth.

Similar concentration is evident when examined in the light of the share of the total income earned. Statistics of Income show that the largest corporations (with assets of 50 million dollars and over) comprise less than 0.2 per cent of all corporations but account for about one-half of the total corporate net income. It can be gauged further through the number of wage earners employed. Old Age and Survivors' Insurance records show that in 1939 about one-tenth of one per cent of the 1,774,204 employing organizations covered, accounted for 30.4 per cent of the reported employment.[9]

But more important is the concentration by products. To throw light on this point, a special study was made by the TNEC of 1,807 manufactured products. Concentration ratios were computed for each product on a company basis, the ratio being expressed as the proportion of total value of the product accounted for by the leading four producers of that product. It was found that approximately one-half of the 1,807 products were being manufactured under conditions where the concentration ratio exceeded 75 per cent, while 27 products had concentration ratios above 90 per cent.[10]

Looking ahead to what might be expected in the years to come, Berle and Means stated that, at the rates of growth from 1909 to 1929, by 1950 the 200 largest nonfinancial corporations would control 70 per cent of all corporate activity and that at the rates of growth from 1924 to 1929 no less than 85 per cent would then be under their control.[11] Another illustration of the rapid growth of large-scale enterprise is the phenomenal development of chain stores. In 1900, according to estimates by the Federal Trade Commission, there were approximately 700 chain systems in the retail field with a total of 4,500 stores. By 1928, there were some 20,000 chain systems with nearly 120,000 operating retail units. Thus, chain systems multiplied 28 times and the number of units multiplied around 27 times. In 1929, the Census of Distribution reported 212,620 retail units operated by chain systems. While the number of units decreased some by 1939, the units were larger and their total volume of business was relatively greater.[12]

[8] Senate Document 173, 75th Congress, 3rd Session.

[9] See also Edwin B. George, "How Big Is Big Business," *Dun's Review*, Mar., 1939.

[10] W. L. Thorp and W. F. Crowder, *The Structure of Industry* (TNEC Monograph No. 27), p. 408.

[11] *The Modern Corporation and Private Property*, *op. cit.*, p. 40.

[12] See the various reports of the Federal Trade Commission resulting from "The Chain Store Inquiry," especially Vol. 1, Tables 34 and 36; T. N. Beckman and H. C. Nolen, *The Chain Store Problem* (McGraw-Hill Book Co., 1937); John P. Nichols, *Chain Store Manual* (1936 ed., Institute of Distribution, New York).

Reasons for the rise and stupendous growth of big business, at the expense of small-scale enterprise, are not difficult to find. For one thing, the corporate form of legal organization, although originated as a mere legal device through which business transactions of individuals might be carried on, has evolved into a system whereby the wealth of thousands of persons has been mobilized and surrendered to unified management control. Following the Civil War great impetus was given to this form of organization, and when businessmen began to appreciate the limited liability of the corporate form of organization, coupled with the ability to assemble large amounts of capital, corporations multiplied. Later they grew in size, through mergers and consolidations, including the holding company arrangement. Between 1899 and 1901 fully 200 industrial combinations with a total capitalization of 10 billion dollars were formed. This phenomenon repeated itself after 1925. In manufacturing and mining alone, 4,583 corporations disappeared, between 1925 and 1929, through such mergers and acquisitions.[13]

Technological improvements and inventions making for large-scale production aided big business immeasurably. In this connection the patent system played a prominent role. Modern technology has made the patent right an exclusive passport to large areas of industrial activity. Virtually every product, process, and enterprise is touched in some way by one or more patent grants. Here, then, are two institutions—the patent system and technology—which are highly interrelated. But the patent system, except for revisions and additions of a procedural nature, has remained essentially unchanged, while technology has evolved very rapidly. Consequently, the patent system in action, instead of promoting scientific progress and the useful arts in the interests of the general public, has often been used as a device by big business to divide an industry into noncompeting segments, to close industries to free enterprise, to create economic stagnation through nonutilization of techniques or restricted use of such improvements, and in various ways to short-circuit competition.

Several other factors making for big business growth and domination need but be mentioned. One of them is the legal sanction of the corporation as a natural person while enjoying the legal immortality denied to a natural person. This facilitates accumulation of vast surpluses and unlimited growth in size. Another is the leadership which size can command, although frequently the alleged genius of big business leaders has been grossly exaggerated. Still another factor is the institutionalization of savings and the growing liquidity preference of investors which have siphoned off the greater part of social capital to the central money markets. Special attention is called to investment

[13] TNEC Monograph No. 27, *op. cit.*, p. 233.

trusts, investment banking houses, security exchanges, and great insurance companies. All of these are geared to attract capital from millions of investors and policyholders and to make it available in sizable sums to large business concerns. Again, the very size of big business often made it possible to indulge in what later came to be regarded as unfair competitive or monopolistic practices and to employ aggressive instruments, including strong lobbies, in the struggle for supremacy. Finally, there is the prestige connected with bigness. America is a big country and it has long been a firm believer in bigness. This philosophy became particularly popular after World War I. Bigness came to be worshipped for its own sake; it was heretical to question its accomplishments and merits. Even the intellectuals in our midst have succumbed to this false philosophy and seem to take it for granted that large business is synonymous wth industrial progress, efficiency, economy, and a full measure of social welfare.

At the same time, small business has been suffering from certain inherent and artificial weaknesses and handicaps. First, there are personal limitations. The small concern lacks the continuity and immortality of the large corporation. Its success and continued existence is closely tied to the person of the owner-managers. Prolonged illness of an individual proprietor or partner may very easily bring business failure; the same may be true of the small, close, or private corporation. At best, it may place the business in a precarious financial position. Second, small business operates with limited financial resources, which can be readily strained through illness or other temporarily adverse circumstances. It is made especially vulnerable because it is financed largely through short-term credit.

Third, possibilities for functional specialization are limited, yet management problems are becoming more complex. The multiplying problems arising out of the evolving closer relationships of government and business aggravate the situation. One need but mention the numerous reports that must be filed and inquiries filled out for social security, tax, census, and other purposes. The small business has neither the time, knowledge, or specialized talent to comply with these requirements, or to take advantage of their legal prerogatives.

Fourth, small business is more seriously affected by depressions. During the Great Depression of the early thirties "small business was displaced from entire industries, and everywhere it experienced competitive deterioration."[14] Firms with substantial amounts of capital survive the longest and have the smallest mortality rate. Moreover, such firms come out of a depression sooner. According to the Statistics of Income, the percentage of deficit corporations to total corporations

[14] *Problems of Small Business* (TNEC Monograph No. 17, 1941), p. 241.

was a little over 64 in 1931 for small (less than $50,000 asset class) and large (over $1,000,000 asset class) corporations alike. For the large corporations, this ratio went up to 75.35 per cent in 1932 and then began to decline until it reached about 34 per cent in 1936 and 1937. But for the small corporations the ratio went up in 1932 to 83.77 and then declined but slightly to 64.06 in 1936 and to 67.07 in 1937. Small business suffers more during a severe business setback and its recuperative power is feeble indeed. Thus, as a result of depressions, small business tends to become smaller and big business grows relatively bigger and stronger.

War has a similar effect. Small business is generally not geared for large-scale production of heavy war goods. To this must be added the prejudices of war agencies and their understandable desire to ease their own task by dealing with a relatively small number of large concerns. All sorts of rationalizations are then made about the larger concerns' "know how," superior ability to convert to war production, etc. Not only are small firms prevented from engaging in war production, but they are equally handicapped on the civilian goods front through priorities, allocations, freeze orders, and general curtailments. It is quite possible that when the final tallies are made, one-half million small businesses will have disappeared as casualties of the present world struggle.

From the foregoing analysis it is apparent that, let alone, the postwar world will tend to be dominated more than ever by big business, with small business playing a rapidly declining role. Yet both size classes have their contributions to make. It must be admitted, certainly, that small business is essential to the preservation of competitive capitalism—the traditional American economic system wherein the ownership and control of productive resources have remained largely in private hands. The active existence of numerous small business firms, each exercising a reasonable degree of freedom and independence, is basic to the maintenance of a competitive market. Should small enterprise dwindle or disappear, and total business activity come under the control of a small number of giant business concerns, the ultimate ownership and control of productive resources by the state would become inescapable, for that would be the only effective means of protecting the interests of society.

Competitive capitalism insures freedom of enterprise—freedom to enter business, to grow, to achieve, even to fail. It provides an outlet for individual creative impulses and abilities and a livelihood for a large segment of the total population. In 1939 there were 2,826,552 active proprietors and firm members of unincorporated businesses in the economic areas covered by the Census of Business, constituting the

largest group of self-employed persons in the entire economy. To these should be added at least 287,133 persons acting in a proprietorship capacity in as many small corporations with assets of less than $100,000 per firm. In addition, small concerns with less than 200 employees each, employed in 1939, according to the Old Age and Survivors' Insurance reports, 51.8 per cent of all workers reported. Moreover, employment in small business is relatively more stable. During a period of years from 1914 through 1939 the index of employment of all small manufacturing plants (with 50 wage earners or less) showed a range of but 28.6 points, compared to a range of 46.3 points for the large plants with more than 500 wage earners each.[15]

We have in this country about 136 million inhabitants, who must be fed, clothed, housed, and otherwise served. Many of these consumers prefer to patronize the local, small business owner-manager, where they may enjoy personal contact with the proprietor, secure individualized treatment, obtain the kind of credit and delivery service they desire, and gain concessions and privileges without having to refer the matter to headquarters for a decision. The facts that about 60 per cent of all retail business is still done by the independent and small businessman, that one-third of all retail sales are normally made on credit, that over one-half of the goods purchased by consumers are delivered, and that the large mail-order houses have made so little progress by the mail method, certainly speak for themselves. Few chain systems have found it possible to render such services on an economical basis and few of them indeed have entered the sparsely populated areas where a large portion of the total population resides. In times of emergency, as during this war, the consumer has come to depend upon the local businessman more than ever, for delivery and for reasonable and personal treatment in the matter of service and rationed merchandise. And, most important, when the difference in actual services is considered, the goods are often obtained at no net increase in cost.

Farmers are equally dependent upon small business for the marketing of their crops through the thousands of assemblers and country buyers and the thousands of commission merchants, wholesalers, and jobbers in the city markets. Likewise, the local manufacturing plants serve as excellent outlets for the farmer's products destined for canning, preserving, and dehydration.

Finally, small business is essential to the maintenance of big business. A large farm machinery manufacturer recently advertised the following statement: "We are a customer of more than 10,000 different businesses, and we market our products through more than 10,000 other businesses. We want little business to survive the War. For we

[15] Census of Manufactures, 1939; also TNEC Monograph No. 27, *op. cit.*, Table 3.

know full well that big business cannot survive without little business."[16] Not only does small business furnish the essential distribution facilities for big business; it is also a source of parts and supplies, as indicated by a recent statement made by General Motors to the effect that 18,735 separate organizations are now supplying them with parts and materials on a subcontracting basis, and 43 per cent of them employed less than 100 workers each. It continued to state that "subcontracting is merely a wartime extension of a time-honored General Motors method. We have always dealt with thousands of suppliers of materials and parts."[17]

In fact, the very basis of big business and mass production, strangely enough, lies in small enterprise. Reference is had to the machine tool industries without which big business, as we know it, could not exist. Yet this embodiment and fruition of the Industrial Revolution is characteristically a small-scale industry, often building for a customer a single machine adapted to one particular job. Of the 200 establishments comprising the machine tool industry in 1939, only 39 plants were large enough to employ 250 or more workers, although, it must be admitted, these 39 plants produced 73.2 per cent of the value of products of the industry. However, the allied industry which produces machine tool accessories, consisting in 1939 of 954 plants, had only 13 plants with 250 or more workers and these plants produced but 19.7 per cent of the value of products of the industry.[18]

Now, the question may be raised: How about the cost of maintaining a larger number of small enterprises? What about the competitive capacity of small concerns? The obvious implication here is that small business is generally or inherently inefficient and that the competitive mechanism is merely performing its function in eliminating the inefficient.

For clarity of statement of whatever facts are available on the subject, distinction must be made between technical or engineering efficiency having to do with the ratio between input and output, business or cost-accounting efficiency as determined by the amount of net gain for the enterprise, and economic efficiency resulting from achieveing the highest level of consumption compatible with a socially desired institutional framework.

One of the most comprehensive studies made with regard to relative efficiency and business size was that conducted by the Federal Trade Commission at the request of the TNEC.[19] A total of 233 tests cover-

[16] "Small Business Out of the Forgotten-Man Class," *Domestic Commerce*, April 8, 1943.
[17] Full page statement in the Columbus *Dispatch*, July 6, 1943, p. 10-B.
[18] Derived from the *Census of Manufactures: 1940*, Table 3.
[19] *Relative Efficiency of Large, Medium-Sized, and Small Business* (TNEC Monograph No. 13, by Federal Trade Commission, 1941).

ing 18 industries were made in regard to relative production costs and earnings ratios. These two standards were chosen because they are respected by businessmen themselves and because they are susceptible of statistical measurement. Of these tests, 53 covered individual-plant costs in the production of cement, pig iron, steel ingots, crude oil, refined petroleum products, beet sugar, raw cane sugar, and refined cane sugar. In only two of these tests did the largest plant have the lowest cost, while in 26 of the tests the small plants were in the "lowest cost" position for the industry.

Similar results were obtained from an independent analysis of the average value added per wage earner in 28 selected industries, the choice of the industries being determined by their volume importance and the presence of both sizes of plants. The data were adapted from the Census of Manufactures for 1939. In 16 of these industries the small plants employing 250 workers or less had a greater value contribution per worker than did the larger plants. These facts suffice to explode the myth that large plants are more efficient. And this is as might be expected after some reflection, for there is no reason why mass production methods involving a considerable degree of specialization, division of labor, and sagacious management of men, machines, and materials cannot be applied successfully in small and medium-sized manufacturing plants. Some leading industrial engineers, after an exhaustive survey of the industrial system, sponsored by the Society for Industrial Engineers, declared that in applying mass production methods "the emphasis should be laid not on size but on the production method. We have worked out optimum size plants for these four basic industries (machine tools, pig iron, lumber, and petroleum products). In every case the range of capacity is the small plant."[20]

As a matter of fact, plants may be too large for efficiency, not only in terms of unit costs, but also through the loss of flexibility and adaptability. "This opinion is borne out by the fact that many manufacturing plants of moderate size have existed and competed successfully against very large plants, in many cases being able to undersell their larger competitors and without the protection of patents and trade secrets."[21]

Large businesses, however, may gain certain economies and enjoy advantages other than those of a technical nature and connected with physical plant size. Advantages may issue from the fact that they operate several plants and from the combination benefit administratively, commercially, strategically, and financially. They may thus be able to

[20] Study conducted by L. P. Alford, Consulting Engineer, and J. E. Hanum, Editor of the Engineering Service Index. See New York *Herald-Tribune,* Dec. 14, 1933.
[21] Dexter S. Kimball, *Industrial Economics* (McGraw-Hill Book Co., 1929), pp. 115-116.

purchase their materials and supplies at lower prices, deal more effectively with labor, obtain capital at lower cost, receive more favored treatment from transportation companies, support research departments and specalized laboratory staffs, control distribution more effectively, secure economies in advertising and selling, and obtain continuous operation of their plants. Critics point out, however, that buying advantages of large businesses often result from the abuse of financial and economic power rather than technical efficiency, that shipping concessions have often taken the form of illegal rebates without economic justification, that promotional profits and underwriting fees often make capital costly, and that the advantages of managerial specialization may be offset by red tape, remote control methods, increased complexity, and irresponsibility of absentee ownership.

In view of these conflicting notions, it is interesting to observe the findings of the Federal Trade Commission study of company size, not plant size, in relation to production costs and rates of return. Of 59 individual company tests, in only one case did the largest company have the lowest cost per unit, while in 37 of the 59 tests, companies classified as small had the lowest cost. Of the 84 tests for individual companies on the rate of return on invested capital, 12 of the large companies had the highest rate, 13 of the small companies made a similar showing, and 57 of the medium-sized companies were at the top in this respect.

These facts certainly challenge the contention that big business is relatively more efficient and that small business is inherently inefficient. Certainly, big business has no monopoly on efficiency any more than it has a monopoly on brains. It is a matter of common knowledge among students of the subject that in essentially all branches of industry and trade some small firms have matched and even surpassed the efficiency record of the larger companies. On the other hand, big business may suffer from inefficiencies to which small business is immune. Often big enterprise is promoted for financial manipulation, monopoly control, exploitation, and other sinister purposes. Integration of functions has often proved more costly than specialization. The larger overhead costs and the inertia that go with size in business, as in government, are other handicaps.

It is believed that if some of the exogenous pressures which unequally and unjustly burden small business were removed, small business would be able to meet competition on a purely efficiency basis and that even a higher level of efficiency might well be expected from it. But efficiency alone is not the only reason for postwar institutional reconstruction that would enable small business to exist and prosper side by side with its bigger rivals. There are other values, too, to be de-

rived from such a procedure. There are, for example, the broader economic considerations of preserving the traditional American system of competitive capitalism, of protecting freedom of enterprise, and insuring "ownership with responsibility."

Then there are the sociological and political values to be considered. Were it not for the self-employment of small business enterprise, we would now be a nation of clerks and employees. Hundreds of thousands of persons not generally wanted by large employers because of age or infirmity are productively and gainfully occupied, thereby removing a burden from social security. Small enterprise is truly the backbone of American community life. Its owners and their families constitute the great middle class in our society, exert a stabilizing influence on our social order, and help to preserve a democratic society. They are also the local civic leaders; they own their homes, and support local institutions and organizations. Small business often makes for "ownership with responsibility, or ownership with a 'conscience.'" Finally, it may well be regarded for a large segment of our population as a "way of life," just as farming is to another large segment of our population.

From the foregoing it would appear to be sound public policy to preserve small business enterprise and to strengthen it in several directions. Let it be emphasized, again, that under a truly competitive system, free from abuse and special institutional developments, the contributions and efficiency of small business would preclude the necessity for any aid from the outside. Even under present conditions, there is no need for crutches in the form of subsidies or special favors. What is sorely needed is action to remove the principal institutional and artificial pressures which unfairly burden small business and which grossly discriminate against it. For this purpose social rationality and action are needed in several directions, as suggested in the following outline:

1. Establishment and maintenance of a reasonable and fair level of competition. Much of our regulatory legislation, including the Sherman Antitrust Act, the Clayton Act, the Federal Trade Commission Act, the Robinson-Patman Act, the State Fair Trade Laws and the Miller-Tydings Act, and the Unfair Trade Practices Acts, are examples of attempts to do just that, but enforcement machinery has been woefully weak and ineffectual. Perhaps a frontal attack should also be made on the whole problem of business concentration through corporate structure and patent reforms.
2. A declaration of social objectives and purposes in order to clarify our attitude toward the economic structure that is desired, a kind of Atlantic Charter with regard to the socially desirable business structure.
3. Education to dispel the ignorance concerning small business, from which stems much of the unfair discrimination. Responsibility for enlightenment on this subject logically falls upon government. This can be accomplished in part through the establishment of a Bureau of Small Business Research and Education.
4. Research for the benefit of small business similar to what has been done by the government for agriculture, and for the same reasons. In both instances, the enterprises are too small to do their own research and cannot rely upon the big business concerns to do it for them.
5. Protection of small business interests against abuse not only from large competitors but from the government itself, just as the farmer is protected by the Department

of Agriculture, labor by the Department of Labor, and big business by several well-known governmental and private agencies. Had small business been properly represented, many of the obstacles, discriminations, and abuses during this emergency would have been forestalled.

6. Alleviation of the capital and credit stringency facing small enterprise by providing the necessary sources of risk capital and long-term credit and thus putting small business more on a par in that respect with its bigger rivals. On this there has been much discussion in recent sessions of the Congress, almost unanimity of agreement that something must be done, but as yet there has been no action.[22]

It is the author's considered judgment that the title of this paper need not be "Large *versus* Small Business after the War," for, in his opinion, it should not be a problem of one or the other. Both large and small businesses have made notable contributions to the progress of this nation and of the civilized world, and both can continue to do so in the future. But certain institutional and other developments during this century, coupled with crass ignorance and general apathy, have so seriously crippled small business that unless definite action is taken somewhat along the lines indicated, there is danger that small business will dwindle and that the seven fat cows of big business will not only eat up the seven lean cows of small business, but that some of the fat ones will also devour the others. If, however, statesmanship is applied to the problem, then the topic might be changed to read, "Large *and* Small Business after the War," both thriving and prospering in an atmosphere conducive to the maximum welfare of society.

[22] See, for example, *Hearings* before the Special Committee to Study and Survey Problems of Small Business Enterprises, U. S. Senate, 78th Congress, 1st Session, Part 15 (Long-Term and Equity Capital), 1943.

# "FULL" EMPLOYMENT IN A PRIVATE ENTERPRISE SYSTEM[1]

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This paper is concerned with the conditions which are important for the achievement of approximately full utilization of resources. It is focused, not on the peculiar problems of minimizing unemployment as we make the transition from a controlled wartime economy to a free-market peacetime economy, but on the problems which will continue to be with us after the main effects of the war are spent.

To preclude misunderstanding, let me define what I mean by "full" employment. It is not overemployment such as we have now, when many persons would prefer to retire from the labor force or to work shorter hours if they were free to make the decision on ordinary economic grounds. It is not 100 per cent complete employment. It is not a job ready and waiting for everyone, no matter where or at what occupation he wants to work. None of these conditions is, on net balance, desirable in normal times.

By "full" employment I mean optimum or best level of employment. At this optimum level workers would be free to move from less to more desirable jobs even though that would entail some loss of gainfully occupied time. Similarly consumers and producers would have freedom of choice, even though that would lead inevitably to temporary maladjustments in some places and in some industries between the jobs to be had and the men and women seeking work. Moreover, there would be some unemployables whose productivity was too low to qualify for the wages which prevailed for the jobs they sought. At the optimum level of employment, the labor market would not be so tight as to prevent the maintenance of a reasonably stable price level. Under the best of conditions attainable in a free-choice economy there would be frictional unemployment. Even now in the face of abnormal, inflationary demands for labor, 1 per cent to 1½ per cent of the labor force is unemployed. In normal times frictional unemployment would be higher, probably from 2 per cent to 5 per cent, and "full" employment, as I use the term, would prevail when some 95 per cent to 98 per cent of those actively seeking work had jobs.

Private enterprise economies, especially as they have become industrialized, have experienced large fluctuations in business activity and in peacetime have not enjoyed full employment except for short periods. In the United States, even the exceptional prosperity of the twenties

[1] The Committee for Economic Development, with which the author is associated, is in no way responsible for the statements in this paper.

began and ended in depression and was punctuated by the recessions of 1924 and 1927. The Great Depression of the thirties brought mass unemployment which persisted for a decade and yielded finally only to the wartime expansion of demand caused by government buying with newly created money. In these days of manpower shortages it is sobering and instructive to remember that in the eleven years before the war we did not find a way to escape from, let alone prevent, mass idleness of men and machines. After the war, we shall be confronted with the same problem again. Unless we find means to cope with it better than we have thus far, we shall again have recurrent, if not persistent, mass unemployment with all the human loss, all the defensive and restrictive measures, and all the dangers to our freedoms which it will entail.

This is not the place to examine the particular causes of past depressions or to evaluate the various theories of business fluctuations. It is essential, however, that we arrive at some common understanding of the dominant forces which bring about increases and decreases in the general level of employment and production. This is less difficult than might be expected. There is, I believe, rather general agreement on the following propositions:

1. Changes in the aggregate demand for products by consumers, producers and government are the major immediate cause of fluctuations in the levels of production and employment.

   Changes in this aggregate demand are caused mainly by:

   a. Shifts in the desire for liquidity, i.e., for money balances as compared with goods and securities, on the part of individuals and businesses, taking the form of attempts to increase cash balances (and pay off debt) or to decrease cash balances (and incur additional debt).
   b. Changes in the net balance of receipts and expenditures by government (especially insofar as this balance involves a change in the total volume of money in circulation).
   c. Changes in the rate of interest and the availability of loan funds (especially from banks).
   d. Changes in the distribution of the national income.
   e. Changes in the incomes of individuals and businesses induced by the foregoing factors.
2. Changes in aggregate demand tend to produce further cumulative changes in demand. This is brought about partly via induced changes in incomes, partly via changes in the adequacy of producers' facilities and inventories to service the demand, partly via sympathetic psychological reactions, and partly via expectations of price movements. Within considerable ranges the general equilibrium is unstable and, in particular, declines from high

levels of activity are not quickly checked by automatic corrective forces. Ultimately, however, even in the absence of government intervention, cumulative shifts in demand are checked by changes in the relation of money incomes to cash balances, by changes in stocks of goods, by changes in the distribution of the national income, and by the reversal of speculative expectations. The net effect of these forces has been to produce large fluctuations in business activity and an average level of utilization of resources considerably short of "full" or optimum employment. Moreover, it can be expected that the magnitude of business fluctuations will tend to become larger, and the average level of employment relative to the labor force lower, as incomes rise and the proportion of income spent on consumers durable goods and invested in producers goods increases. The greater our economic progress, the more acute will be the need for ways and means to combat the tendencies toward depression.

3. For the most part, changes in the supply (i.e., offerings) of goods and services produced are not a dominant proximate cause of business fluctuations. Monopolistic restrictions on supply and price in either business or labor may, however, constitute very serious structural defects in the economy which restrict opportunities for expanding investment and lessen the resiliency of the economy in its adjustment to changes in demand.
4. Industrial stagnation and mass unemployment, once begun, can continue for long periods of time—not only for years but possibly even for decades—in an economy of inflexible prices and wage rates. Such stagnation is due to the failure of consumer and investment demand to expand and draw idle resources into employment. In particular, investment opportunities to enlarge old businesses and start new businesses may appear unattractive because of a variety of factors, such as: the very presence of excess productive capacity; poor profit prospects, in the opinion of investors, because of fear of arbitrary action by government or by labor unions; a reduction in the nonpecuniary perquisites of business enterprisers—status in the community and pleasure in the job; the attractiveness of nonenterprise employments for investment funds and business talent; the lack of institutional arrangements to channel personal savings into business investment; the failure of invention to open new, large-scale opportunities for investment; and, in the long run, the reduction in the marginal productivity of capital resulting from the increase in the amount of capital per worker.[2] Finally, let me point out that a period of stag-

[2] Although I cannot debate the mature-economy issue here, I do wish to indicate that there are other plausible explanations for the stagnation of the thirties.

nation can be terminated by various events which substantially increase the demand for goods, such as a surge of optimism, the opening of large opportunities for new investment, a war, or the deliberate action of government.

In submitting these propositions I make no pretense at a complete explanation of business cycle phenomena. If, in the main, however, these fragmentary and sketchy statements are acceptable, they will provide some common orientation for our appraisal of ways and means to cope with the threat of unemployment.

At this point I must acknowledge a debt to Professor J. M. Clark for his reference to a little book, *How to Play a Hole of Golf in Fifteen,* and for his suggestion that it provides a useful pattern of approach to some of our postwar problems. Let us consider briefly "how not to do it."

The war has given us a spectacular demonstration of the efficacy of a great increase in demand in pulling idle resources into employment. The demonstration has also proceeded far enough to give us some partial realization of the tremendous strains and inflationary pressures incident to greatly excessive deficit financing. Even in time of war these disruptive forces threaten to impair our production effort; in time of peace they would burst all restraints and plunge us into chaos. Deficit financing (in excess of what may be necessary to supply the normal money requirements of an expanding economy) is a dangerous drug. In proper doses it can provide an extremely valuable and, in some cases, desperately needed stimulus; in large overdoses, it can cause convulsions. When we use this stimulant we must do so with discretion and self-restraint. And we must not neglect or aggravate the organic difficulties which call for its injection.

After the war there will be a clamor for solving the unemployment problem by shortening hours, spreading the work, and thus reducing the supply of labor. As a stopgap remedy this will spread the burden of existing unemployment and lessen the intensity of its incidence. But we shall never raise our standards of living by producing less. This is the counsel of despair. Everyone must endorse a shorter work week if more leisure is preferable to more goods and services; but the decision must be made on these grounds. We cannot countenance the proposal of shorter hours in order to freeze unemployment into the structure of the economy. We must find means to employ, not curtail, the productive efforts of men and women who want full opportunity to work.

In the process of conversion from war to peace the status of many groups in the economy—some in business, some in labor, and some in agriculture—will be threatened by the changed patterns of demand. These groups will look for refuge from the competition which excess

capacity may induce and will try to extend the windfall gains brought them by the war. In some cases there is merit in their claims for protection against cutthroat competition. But such protection must be rigorously limited to cases of exceptional hardship and must be extended in the form of government regulation which is strictly temporary, not in the form of grants of monopolistic privilege. We cannot afford a postwar NRA. We cannot give jurisdiction over prices, wages, production, capacity, and technological progress to industry organizations composed of representatives of business and labor. The interests of such industry groups are too sharply in conflict with the public interest for them to be entrusted with such powers. If we are to have a progressive, dynamic economy, it must be one in which there is maximum opportunity for all, not one hedged about with restrictive and protective measures serving the special interests of particular groups.

In addressing myself to the question, "How to do it," I do not propose any panacea. I do not have a simple blueprint of the means to achieve continuous "full" employment in a private enterprise system. I shall, however, indicate the main general lines along which we must work if we are to achieve fuller use of our productive resources and progressively higher standards of living. And I shall propose some specific measures to these ends.

This program pointed toward "full" employment has three major, though not independent, parts: (1) fiscal and monetary action by the government to maintain the demand for goods and services at high levels and to prevent excessive demand which will spend itself in a price-wage spiral; (2) development of a price-wage structure with at least moderate flexibility in both directions (also maximum mobility of resources and freedom of access to alternative employments); (3) provision of adequate incentives for enterprise.

The major objective of fiscal policy should be to counteract tendencies toward a deflationary decline in demand or toward an inflationary price-wage increase. One of the specific suggestions to this end is the proposal by Beardsley Ruml to "balance the budget at an agreed level of high employment" and having set our tax rates to accomplish this, to "leave them alone, except as there are major changes in national policy. When employment goes beyond an agreed level, or if, with high employment, we have a boom in prices, let us hold the surplus or use it to reduce the national debt, not as an excuse for further tax reduction."[3] A progressive income tax on individuals, with minimum reliance on excises, and with current collection, would yield a pattern of revenue with much larger relative fluctuations than those in the national in-

[3] Address by Beardsley Ruml, "Post War Fiscal Policy."

come. This makes sense. There is no point in striving for adequacy of revenue in depression. We may with great advantage achieve a substantial part of deficit financing in depression by collecting less taxes instead of looking for more ways to spend money.

Although this proposal by Ruml is certainly a step in the right direction, there is reason to doubt whether fixed income-tax rates would produce sufficient fluctuations in government revenue and conversely in disposable funds of individuals to neutralize fully the tendencies in the business system toward inflation and deflation. It would be possible, however, to neutralize such tendencies completely by adopting a sliding scale of personal exemptions (and perhaps also of rates) keyed to the volume of unemployment and the price level. Obviously tax rates could check any tendency toward inflation if they were raised high enough. Similarly a reduction in tax rates, extended if necessary to include temporary negative rates, could counteract any tendency toward depression. The mechanical difficulties in such a plan are not so very great. And its operation would involve slight delay and no serious inferior use of resources such as are inevitable in any huge public works program to provide employment.

On the expenditure side of the budget, the outlays for ordinary operations should be comparatively stable but the deferrable expenditures for public works and services and, if necessary, for relief should be scheduled so as to vary inversely with the ups and downs of business. I do not undertake to say how large expenditures on public works should be. There are obvious objections to employing productive resources on projects of minor importance just to provide employment, when individuals would much prefer more of the things they normally consume. Make-work employment is demoralizing to those engaged in it and lends itself too readily to the uses of machine politics. The real objective of deficit spending should be the maintenance of the demand for goods, not the provision of employment. This is, in fact, mainly a matter of morality and self-control rather than one of technique. We know how the government can manufacture money and retire money; we know how the government can hand it out to persons and get it back from them; but we do not quite know how to do some of these things without violating our taboos and corrupting ourselves. On this front the search for truth and understanding must go forward.

I hope I shall not be misunderstood with reference to public works. If we do not develop better ways of coping with the threat of unemployment, by all means let us have public works—on a large scale, carefully prepared in advance, and efficiently constructed. Let us resort, if need be, to projects of secondary and tertiary desirability up to the margin of pure make-work. But let us not deceive ourselves that we

have found a good solution to the unemployment problem. Instead, let the surplus public works serve as monuments to our lack of imagination and the low level of our public morals!

On the subjects of open-market operations by the banking system and of management of the public debt, I speak with hesitation because I speak without special competence. Certainly, however, the purchase and sale of governments by the Federal Reserve System and the Treasury afford a means to counter quickly any tendencies toward depression or toward price inflation. These operations can, of course, be conducted on a very large scale if we will only give up the fetish of an arbitrarily low interest rate and let commercial banks and insurance companies value government bonds at cost plus or minus unamortized premium or discount. To be most effective, these operations should be in long-term governments (or, better still, in consols) which are held as investments, not as money-equivalent. Moreover, these operations should be conducted with full realization that if they are successful they will net a substantial loss which the government will have to underwrite.

In this connection let me interpolate a few words on the national debt. If we wish, it seems to me we can retire the debt at a fairly rapid rate without particular fear of deflation, because there are almost unlimited possibilities of monetizing outstanding debt as an antideflationary measure. Furthermore, as a means to combat deflation, the conversion of part of the public debt into non-interest bearing obligations, i.e., money, is infinitely to be preferred to huge deficit spending on unneeded public works or even to continued deficit financing via reduced taxes, both of which will increase the government debt and the expenditures necessary to service it.

General and selective credit controls are useful and effective devices to restrain inflationary developments based on credit but they have little value in stimulating business activity in depression.

The existence of large volumes of personal and business debt in the economic structure intensifies business fluctuations. Consumer credit rises in prosperity and declines in depression, and bank credits to business show a similar pattern. Business debt, moreover, increases the danger of failure in depression. Insofar as we can, we ought to keep our cyclically fluctuating debt to a minimum and to promote in every way the substitution of equity in place of debt capital.

Finally, there is imperative need for the co-ordination of all bodies possessing fiscal and monetary powers in the federal government to facilitate the proper use of such powers for the maintenance and restraint, when respectively necessary, of the demand for goods and services. Further reinforcement can be provided by intelligent action on

the part of state and local governments to orient their own fiscal policies, insofar as possible, to contribute to the same ends as national policy.

I turn now to some of the structural aspects of the economy which are important for the attainment of high levels of employment and production.

Price and wage flexibility has long been advocated by economists as a means to lessen the severity of business fluctuations. On the assumption of a relatively stable stock of money, it is true that cumulative movements in production and employment will be checked more quickly by more flexible prices, provided the drop in prices in depression does not lead to a large volume of business failures and provided price movements do not induce large changes in business sentiment. There are, however, important qualifications. There is also the hard fact that the degree of price flexibility which would be required to maintain fairly high utilization of resources could not be achieved by any structural changes in the economy that would, on balance, be regarded as desirable, much less feasible. In my judgment we cannot put our main reliance in price flexibility to prevent or cure unemployment.

There are, none the less, very strong reasons for advocating the kind of changes which would lessen the degree of monopoly and imperfection of competition in the system. Any program pointed toward "full" employment is threatened by the danger that monopolistic powers, especially over wage rates and agricultural prices, may be used to produce a wage-price spiral even before "full" employment is achieved. If this happens the price of "full" employment is inflation—and the price is too high. The effects of a one-way ratchet on prices or wages can be offset to a considerable extent by inflationary monetary action—but only by doing great injury and injustice to those whose incomes are comparatively fixed. A private enterprise system can tolerate an amazing amount of monopoly, especially if fiscal and monetary measures are used to cope with depressions; but unless the trends toward monopolistic organization in business, labor, and agriculture are reversed, our chances to avoid mass unemployment of resources will be substantially impaired.

It is important to develop concurrently programs of action to maintain demand by fiscal and monetary means and to reduce the degree of monopoly and rigidity in the system. Many of the restrictive and defensive practices of business, labor, and agriculture were devised as protection against the impact of reduced demand in depression. Many of them will be abandoned without much of a struggle if the need for such protection is not felt to be so urgent.

An exploration of the problems of monopoly and imperfect competi-

tion would lead us far afield and involve other important objectives in addition to "full" employment. Let me, therefore, merely repeat that the prevention of upward wage-price spirals induced by monopoly action is a vital matter if we are to place much reliance in monetary and fiscal measures, as I am convinced we should. Furthermore, the latent threat of use of monopoly powers by businesses and labor unions may be an important deterrent to new ventures. Finally, a greater flexibility in prices would somewhat facilitate the automatic checking of cumulative fluctuations in employment and business. All this adds up to the fact that the cause of "full" employment would be greatly aided by a substantial reduction in monopolistic controls over prices and wages.

In addition to counter-monopoly measures, there is need to improve the mobility of resources and their access to alternative employments. This will lessen the urge to rely on defensive and restrictive practices and it will also open up opportunities for business expansion. Thus, *inter alia,* we need better employment services, elimination of residence restrictions to qualify for unemployment and relief benefits, higher unemployment benefits, better information on business opportunities, and improved technical services and education to help small businessmen take advantage of technological progress.

On the subject of incentives for enterprise I shall be brief.

In a private enterprise system the prospect of profits constitutes the main inducement for employment of resources. These prospects in turn depend in large degree on the demand for goods. A proper fiscal and monetary policy pointed toward maintaining demand would therefore constitute a most important stimulus to employment and investment.

After the war the returns to be had from business enterprise will be affected greatly by the system of taxes adopted. If the objective is "full" employment, it is fairly clear that the double taxation of profits should cease, that the excess profits tax should be repealed, that the corporation income tax should be abolished, and that we should rely on full taxation of profits and gains from business ventures to the persons who receive such income. Our tax system would then consist mainly of a progressive personal income tax with a broad base. Furthermore, enterprisers in small unincorporated businesses should be freed from unfair taxation by generous provisions for carrying forward of losses or for averaging of income over a considerable number of years. In passing, it should be recognized that the elimination of taxes on businesses as such will result in higher wages and lower prices as well as in increased net profits. These reforms, which involve a reduction in government revenues, must, of course, wait till after the war.

There cannot be much doubt that the fear of arbitrary action by

labor unions has dimmed the prospects of profits in the eyes of potential enterprisers and investors. Time will help to clarify the uncertainties from this source beclouding many capital commitments and will, let us hope, tend also to lead to patterns of demands by unions and to determinations of wages by negotiation and arbitration which will not encroach on profit levels so far as to cause serious limitation of investment. In the meantime this is an urgent matter for consideration and policy formation by union leaders and for investigation and appraisal by students of business-labor relations.

I do not believe that the general level of profits before the war was too low to induce an expansion of business if other factors had been more favorable. After the war when price controls are removed, profits will again be determined by market forces. I certainly should not advocate trying to bolster profit margins by artificial maintenance of prices. Instead, greater incentives for enterprise can be provided by reducing the uncertainties and unpleasantness in labor-business and government-business relations and, if depression threatens, by bolstering the demand for goods by fiscal and monetary means.

In the case of new businesses and small business there is reason for providing special encouragement, perhaps in the form of special tax privileges, certainly in the form of improved technical services by the government.

These general comments on "how to do it" are not by any means complete. I realize there are other relevant and important factors which might well be discussed in this connection. It must also be apparent that we do not as yet have all the technical "know-how" or anything like the understanding and responsibility on the part of the public which are necessary to achieve "full" employment in a private enterprise system. We need more study and research; we need more economic statesmen to lead the way; and, above all, we need more education of the public to induce them to support intelligent leadership.

In conclusion, a word on the incidence of responsibility for achieving "full" employment in a private enterprise system. Plainly the main responsibility must rest with the government. The government must formulate and carry out fiscal and monetary policy. The government must set the rules of the game and determine in large part the institutional structure of the economy. "Business" cannot shoulder the responsibility for "full" employment because there is no such entity as business. Individual businesses, except the largest, cannot accomplish a great deal although they can do something by their timing of investment expenditures, by their price policies, and by their ingenuity in developing new outlets for investment. In the aggregate these efforts will have a substantial effect. In times such as this when there is a

fairly definite and challenging job of conversion and expansion after the war, an organization such as the Field Development Division of the Committee for Economic Development can stimulate widespread concerted efforts to raise the level of employment. Ultimately, however, the responsibility must be shouldered by us as individuals: by businessmen, by labor leaders, by politicians, by economists, and especially by all of us as citizens, each according to the knowledge he can contribute and the power he can exercise.

# FACTS AND FANTASIES CONCERNING FULL EMPLOYMENT

*By* Julius Hirsch
*New York City*

The most startling fact in the American economy of today is the miracle of our war production. No one, even the most optimistic, was able to foresee the unparalleled performance of American productive ingenuity.

The volume of the war goods and war services we have produced alone has been almost as large as the greatest volume of civilian goods we have ever produced in peacetime. We outproduce the Axis in war production by 200 per cent. Yet we are producing 10 or perhaps 15 per cent more goods and services for civilian use than in prewar times. (See graph; also *Federal Reserve Bulletin,* January, 1944, page 1.)

In 1929, the year of our greatest prewar prosperity, we employed 48 million people for approximately the same number of hours per day as we do at the present time.[1] Today, employing only about 10 per cent more workers for no more than the same number of hours, we are producing far more than double the total volume of 1929.

The question now is: After this job is done, what will we do with the 9 to 10 million people we have employed through 1943-44 in addition to those employed in 1939? These are the people who have made this greatest production of all times possible. And before all we have to take care of that most precious part of the nation—the 11 million in the armed services.

There can be no doubt that with our huge productive power we will be able to guarantee a decent living for everyone. But we promise much more; namely, full employment! How can we fulfill that promise knowing full well that each hour's labor will yeld so much more than before the war? How can we add to this production miracle the greater one, the consumption miracle?

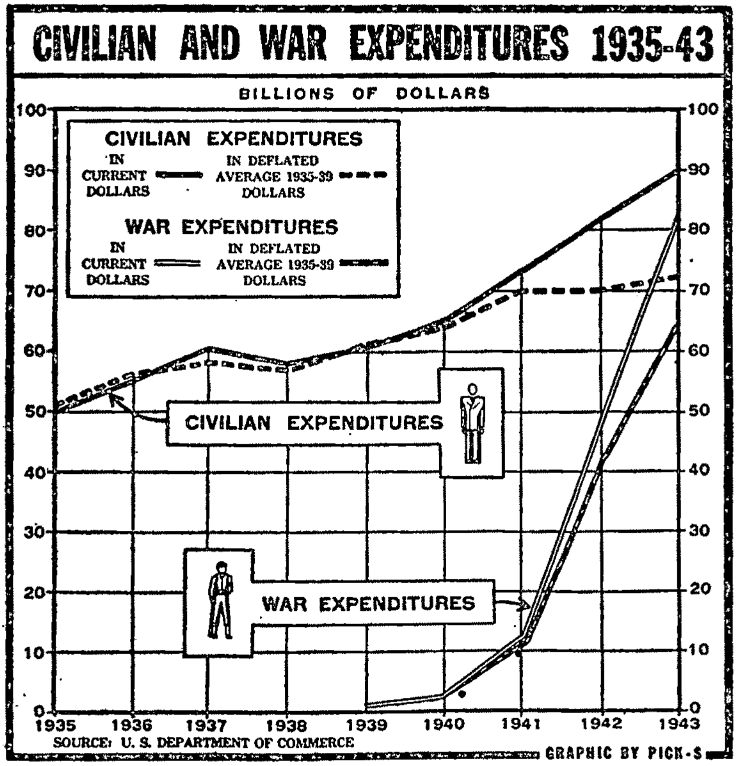
The Department of Commerce, in its well-known, splendidly written pamphlet, *Markets After the War,* argues that if in 1946 we have no more than the same volume of consumption as in 1940, the year which saw the highest prewar consumption in the country's history, we would, mainly owing to the increased productivity, have a total of 19 million unemployed.[2] Therefore, the pamphlet figures tentatively what production ought to be reached if a moderate form of full employment should

[1] *Economic Almanac for 1943-44* (Conference Board), pp. 270-271.

[2] Senate Document No. 40, 78th Congress, 1st Session, Washington, D.C., 1943. The basic assumptions of this document are identical with the very important pamphlet *Demobilization and Readjustment,* Report of the Conference on Postwar Readjustment of Civilian and Military Personnel (National Resources Planning Board), June, 1943.

be attained in 1946. The result is an estimated volume of production 50 per cent higher than in 1940 and valued in dollars of today about 74 per cent higher than the national product of that year.

THE AMERICAN WAR PRODUCTION MIRACLE




The American war production miracle is that we are out-producing the whole Axis by almost 200% in fighting material and at the same time we have increased the volume of civilian production by 12-15%. The increase in civilian business in 1943 indicates that the final figure for this may exceed the estimated $90 billion by $2-3 or even $4 billion.

This graph does not contain the normal expenditure for non-war administration. If this figure of $12-14 billion is added, the "Gross National Income" for 1943 may pass the $190 billion mark.

Some labor leaders, on the other hand, believe that when the business volume begins to fall off, which is bound to happen very soon, it might not stop at the most favorable rate of our best prewar year, 1941 (or rather, the first half of that year), but might fall below the rate so that 30 million and more unemployed would emerge.

There has been something of a cycle in our postwar thinking during the past year. When Alvin Hansen first spoke of a net national postwar income of 100 billion a year, there was an outcry against this optimism.

The pamphlet, *Markets After the War,* while expressly denying that it is a forecast, had the astonishing effect of making a good many businessmen and trade associations accept its figure as a forecast of a net national income of almost 140 billion dollars as the basis of their postwar thinking.

Now, when Mr. Sloane, of General Motors, dared to mention Alvin Hansen's figure which suddenly appeared to be a modest one, not only labor leaders expressed sharp disappointment, but a very high official clearly reproaches the idea that businessmen might make their plans on a basis of "only" 100 billion dollars a year as a kind of "restraint of production." From this we get the impression that it is the plans of businessmen which determine the business cycle. This is certainly extremely flattering for business—but unfortunately it highly overrates what business can do. If business alone could control the business volume, the depression of 1929 would never have happened. Incidentally this high official raises the goal of immediate postwar gross output to 200 billion dollars.

In connection with these optimistic forecasts, we now get the prophecy of a sharp postwar inflation with the wholesale price index rising 200 per cent above the levels of 1926, necessitating price controls and even wage controls as well as rationing for some years to come. Yet in the midst of these prophecies, some deflationary trends suddenly become clearly visible, some rationings disappear, scarcities in raw materials become less, and the nightmare of large-scale unemployment after the first replenishment begins to worry many economic minds. The forecast of 10 to 12 million unemployed for 1946, first given in *Barron's,* July, 1943, was repeated as a serious possibility by officials of the Labor Department, and exceeded by Leon Henderson who arrives at a total of 16 million.[3]

There is almost complete unanimity as to the aim of avoiding another period of mass despair through mass unemployment, which has indeed proved to be the deepest root for the development of dictatorships and ultimately of war in Europe. Here a wrong guess can lead to dangerous neglect of needed action. To rely on fantasies of a hidden miracle which will bring about full employment, perhaps by the means of a sharp inflation, would entail a dangerous failure if a serious inflation did not occur. On the other hand, the picture of 30 million and more unemployed, if accepted as a probability, would almost immediately entail work creation by the government on the basis of a most rigidly planned

[3] Julius Hirsch, "The Post-War Outlook for Jobs," *Barron's Weekly,* July 19 and 26, 1943, and "Shall We Fear Inflation—or Deflation?" *Barron's,* Sept. 6, 1943; John H. G. Pierson, *Employment after the War* (American Federation of Labor, 1943) and "What Chance for Free Enterprise after the War," *Free World,* April, 1943; D. H. Davenport, "Unemployment Immediately after the War," *After the War* (New York University, Jan., 1944); Leon Henderson and Leo Cherne, *Your Business After the War* (New York: Research Institute of America, Oct., 1943).

economy. The facts and even the forecasts of postwar employment are of vital importance to the life of this generation here and abroad. It is a vital necessity to see the facts as clearly and as free from wishful thinking as possible.

There are evidently two methods of arriving at an estimate for postwar employment figures. The first starts with the assumption that the war only interrupted a prewar development, and that it might be safe to assume that this development basically will be continued after the war. In the opinion of this group, the safest forecast for production, consumption, and investment will be to assume a continuation of the volume and the tendencies prevailing before and during 1939, with due adjustments for economic changes like increased efficiency of labor, the high national debt and strongly increased savings, and for a year or two a large pent-up demand.

The second method starts with the assumption that a qualified full employment will be reached with an employed labor force between 53 millions in winter and 55.2 millions in summer, 1946; in both cases the figure of 2.5 million men is contained in the total for armed forces.[4] Besides this, figures of unemployed are assumed at 6.2 million in summer and 4.2 millions in winter. Moreover, the additional assumption is that all the 8.5 million women, older men, and youngsters called to war work will silently return "back to school and kitchen."[5] To bring that about, a gross national output of 50 per cent above that of 1940 or 64 per cent above that of 1939 is seen to be necessary.

The reasoning of these "moderate optimists" rests on the following:

1. Mainly the hope for an unheard-of increase in domestic consumption and investment in durable goods, foodstuffs, textiles, and other commodities and services.

2. The hope for sharply increased foreign trade through fundamental change in our foreign trade policy, in the long run as well as during the early postwar rehabilitation period.

3. These main points are cushioned by the expectation of an upward trend in the price level as, e.g., outlined by S. H. Slichter, who assumes a postwar price level of about 70 per cent above the prewar level, this again strengthened by the expectation of a sharp postwar inflation.

4. The factor of a huge pent-up consumer demand rushing into supply markets immediately after the armistice.

5. The desire for a higher postwar price level to ease the burden of our national debt.

A high price level would certainly ease the national debt. This desire alone cannot bring about a "smaller dollar."

[4] The highest figure of the German standing peacetime army was about 660,000 men; that of the British Navy, including the Reserve, not more than 220,000.

[5] See *Demobilization and Readjustment*, pp. 84-85.

Facts and developments which are clearly visible now convince an undoubtedly growing number of observers that this smooth and ideal procedure will not and even cannot take place.

First, I think that the forecast increase of a normal civilian expenditure for 1946 exceeds by far every probability, even possibility, of which we have any statistical experience or knowledge. Second, I believe that production will again sharply outrun consumption and that the current estimates of postwar employment are completely overoptimistic.

This is decisively strengthened by a third counteracting force; namely, while some inflationary tendencies continue, we now have clearly defined deflationary tendencies as well. After a period of transition which may not continue for long, the deflationary tendencies are bound to become stronger and stronger. Postwar deflation after a rather limited period is much more probable than a lasting inflation.

I expect that in 1945, assuming the European war ends in 1944, the problem of unemployment will be a very serious one, and I expect that from 1946 on, *increasing* prices will not be our worry in most markets, but *decreasing* prices, nationally and internationally, which we will try to prevent with all forces at our command, even at the expense of some foreign trade.

The hope is that we will be able to increase our total civilian consumption by 64 per cent between 1939 and 1946. This would mean an increase of 9 per cent in the volume of our civilian consumption plus investment each year. This assumption exceeds the achievement of every ten-year period from 1900 to 1939. The average yearly increase of national net income which includes net consumption and net investment during the whole period from 1900 to 1939 was about 3.4 per cent; from 1910 to 1939 almost exactly 2 per cent a year. In the period from 1919 to 1929, which we feel was our period of greatest prosperity, we had, if we eliminate the variations in the price level, an increase of national income of 2.7 per cent a year. In the period 1929 to 1938 we had a decrease. And if we take 1929 to 1940, we had a yearly increase of less than 1 per cent within eleven years.[6] Under these circumstances, to plan national consumption on the basis of an annual increase two or three times as high as what has been experienced during this whole century—let alone what we experienced since 1929—must be considered as dangerous overoptimism which can only cloud vital economic decisions.

Let us now consider the basic philosophy of *Markets After the War* that "production makes markets." If our economic mechanics were as simple as that, the whole depression following 1929 with its aftermath of eleven years of heavy unemployment would have been a myth.

[6] See "Total Income Adjusted by the Cost of Living," *Economic Almanac* for 1943-44 (Conference Board), p. 361.

I agree with the list of reasons for depressions given by Dr. Yntema. What, however, was the main point? The economic collapse of 1929 had its origin primarily in the wonderful development of production in agriculture and industry. This forever removed the consequences of the Malthusian theory; but since that time, except for the war, we are still unable to find the consumption which would immediately meet our rapidly increasing rate of production.

After World War II, we shall find we must come to grips with essentially the same problem; namely, the widened gap between consumption and productivity, but the problem will be immeasurably larger. In 1939 the volume of our production was greater than in 1929, but in spite of all our efforts we were never able to absorb a labor surplus of between 8 to 10 million people in the peacetime period since 1929.

In the above-quoted *Barron's* articles I tried to show that in a number of business lines either less employment is likely to occur than in 1939 or not considerably more; for example, agriculture. Our agricultural production today is one-third greater than it was in the last five prewar years. Yet this production was accomplished with no essential increase in the labor employed and with less efficient labor. Even if the assumption is made that with the end of Lend-Lease production will be maintained, the continuing trend of mechanization will lower the manpower requirements. Actually there will be a postwar world surplus of agricultural production in a period during which our agricultural prices are pegged in competition against foreign production. I expect, therefore, that after the war agricultural employment will actually decline by as much as 1 million.

Very much the same thing will happen in the field of railway and water-borne transportation, mining, and other industries. After the enormous expansion of manufacturing and mining industries, I cannot expect great additional investment there—but what is needed can be done with less manpower per unit. Expansion of employment can mainly be expected in some durable goods or "replenishment industries," in new industries and, I hope, in construction. These replenishment industries, however, have represented less than 20 per cent of our national expenditure budget, while in at least 80 per cent of the industries, allowing for some expansion in distribution and services, the best we can hope for is stable employment at prewar levels.[7]

The postwar price inflation that was feared is now apparently considered by some authorities almost a necessity for good postwar employment. I can say from actual experience that serious inflation seems indeed a kind of transitory help for employment, but a rather danger-

[7] The percentage of durable consumers' goods plus private residential construction to total national gross expenditure in 1929 was 13.5%, in 1933, 7.0, in 1938, about 10, and in 1940, about 11%. (*Markets After the War*, p. 26.)

ous one. However, the expectation of a serious postwar inflation does not appear to be based on very solid ground. It starts from two suppositions which came into popular discussion in recent months; namely, (1) from the belief that of the huge amounts of "hot" and "warm" savings which are being accumulated, the hot part will, immediately after the war or the first armistice, rush into the markets and (2) from the belief that these markets will be empty. One estimate, for example, predicts an average price increase of 8 per cent and, according to this opinion, by the end of that year 16.2 billion hot savings will have rushed into the empty markets, causing a further increase of 8 per cent in prices.

While prices, especially for scarce consumers goods, may be somewhat higher immediately after the war, I must disagree completely as to the prospect of "empty markets." However you figure business inventories, it is true that those of the retailers and wholesalers have decreased, but it is also true that those of the manufacturers are much larger. Add to this a modest estimate of 12 billion dollars for government stock piles which can be used for civilian supply if the war ends and you get an inventory large enough to meet the rate of consumption of 1939 plus all the 16 billion dollars of hot savings scheduled to rush into the markets at the end of 1944. And this entirely neglects predictions of earlier reconversion and an increased power of production which will further tend to increase our inventories. Under these circumstances, I am unable to foresee any serious postwar inflation.[8]

From the commodity side, the odds will be rather for deflation than for inflation after the so-called "replenishment" boom has taken its course. Empty markets? We have more wool in this country than our mills can process running at overcapacity if not an ounce of additional wool is added in the next three years; the world's cotton stock piles are higher than even before the war. Our inventories of raw materials are 73 per cent greater than our prewar inventories. Production of metals is already being heavily cut back. If our grain supply is shrinking, this is certainly not because human consumption had increased so much, but because our food policy has increased the number of hogs by 70 per cent since 1939 and the cattle by almost 40 per cent. Now the hogs started a huge run to the packing plants. While with one hand the Treasury pays subsidies to keep consumer meat prices down, the CCC buys with the other hand to hold hog prices up.

Growers of various raw materials in all continents are already approaching the British government asking for an extension of the wartime purchasing guarantee for some postwar years. J. M. Keynes is adding to his currency plan a much more important chapter on stabilizing raw material prices on an international basis—which of course

[8] See *Barron's Weekly*, Feb. 21, 1944, p. 3.

means a world-wide cartelization. Looking around, you will find very few raw materials which will not be available in plenty when the last shot is fired.

The increase of efficiency per manhour will very probably be greater than anything shown in my charts. We did the huge production work with less skilled, unskilled and substandard labor, while millions of our best skilled laborers are drafted. In agriculture, the increase must be between 30 and 33 per cent. In manufacturing industries, opinions differ widely. I think this increase will be even higher—after the engineers for 3 or 4 years have been let loose without regards to cost.

As to the other widely accepted assumption, that the savings will rush to the markets like a torrent, I think they are an extremely valuable cushion. I doubt very much that the public will spend the accumulated amounts like "drunken sailors." The American noneconomists acted in this case more wisely than some of our best economists anticipated. Some of us were sure that the "inflationary gap" would make for high spending and sky-rocketing prices. John Q. Public has learned from rainy days and has saved. The inquiry of the National Planning Association shows that only 11 per cent want to spend their savings right away and that 67 per cent of the low income group and 73 per cent of the others do not intend to spend most of their savings at the end of the war.[9] Only if a runaway inflation should develop would mass liquidation of bonds be likely. Even that is not quite sure, as shown by the example of France.

By this I certainly do not deny the existence of a large pent-up demand. In the first happy weeks and months after the terrible nightmare of war is over, there will be excessive spending. But I think its effect on lasting employment is grossly overestimated. Most spending, aside from amounts spent for cars and other consumers' durable goods, will take the form of spending for construction. Nobody, in fact, expects that the whole pent-up demand for construction and repairs will have to be satisfied in one single year. Besides, even if we accept an estimate of 20 billion or so of spending by dissaving, this does not equal 2½ months of war production, and it is a one-time expenditure. This pent-up demand alone will not create lasting additional consumption.

I feel obliged to warn against a very popular gross overestimation of foreign trade. The long-term trend of foreign trade has been decreasing ever since 1929. The deflationary tendencies which are to be expected almost immediately after the war in this country will after a not too long period also arise in foreign countries. The productivity of their plants, where not destroyed, has also increased, and their will to

[9] *Public Thinking on Post-War Problems* (Planning Pamphlet No. 23, Oct., 1943), pp. 16-18.

export will be more intense than before the war. Some of us voice great expectations about feeding Europe and Asia after the war. As to grains, I do not expect the shortage to last longer than until the next harvest after the European Armistice. The enormous progress made by the European agriculture in using artificial nitrate is not sufficiently known here. The Danish statistics, which I consider to be the most correct, show that by the help of artificial fertilizers, the yield per acre has been increased by about 40 per cent since 1920. From an official source we heard recently that we will be astonished how quickly the European textile industry will recover. Let me add that this will be the case with most industries, and perhaps most of all, with the construction industries. Let us do whatever we reasonably can to help suffering nations, but—do not bank on foreign trade for America's postwar employment.

The developments which I have tried to outline to you are not inexorable. They have, however, sufficient force to cause me to assert that realistic planning must supplant the false hope of completely unrealistic and unforeseen expectations of consumption.

At the end of the war, a total labor force of between 62 to 66 million people may claim employment. We will have no difficulty in creating very great production. It is the active consumption power to absorb that production which will be the problem. The high level of income which we now have will be sharply reduced during the coming year even if not a single person is dismissed from employment. If overtime is scrapped, as it will be, and our labor force has to go from the high war-plant wages to the level of wages in civilian industries, OPA has estimated that our national income will lose from 30 to 35 billion dollars. With every additional million laborers leaving employment, we will lose another 4 billions in net income, and since the last millions created the highest additional increase, probably much more.

With our present methods, I feel it is impossible to create full productive employment for a labor force of 60, 62, or even 58 million persons. Even when in 1939 we figured that 45 millions were employed, 1½ million worked at government created labor in WPA, PWA, and a score of other alphabetical agencies.

On the other hand, experience the world over has proved that hunger for work in modern times is as great and as intolerable as hunger for food was in previous centuries. Therefore, we must find the means of using all those whom we are unable as yet to employ in full-time jobs.

This again must be done within such limits that our huge national debt will not be increased substantially by labor creating methods.

Everyone of us is interested in seeing the nation maintain as much purchasing power as possible. It is rather difficult, however, to see how with the labor time schedules of 1939 we can employ 60 to 62 million

people in normal business enterprise. Even with labor hours reduced from 4 to 5 hours a week and with no corresponding reduction in pay rolls, I do not see how we can employ more than 51 or perhaps 52 million people after the manner of 1939. Therefore, I repeat my proposal that: (a) the sector of private enterprise shall be geared to the highest efficiency with the purpose of creating as high a standard of living as possible with a labor time and wage policy appropriate to this aim; (b) that the sector of public and semipublic enterprise be expanded within the limits of a balanced budget and that construction of all kinds which has a favorable multiplying factor should be furthered by all means; and (c) for those who cannot be employed in these two sectors, occupation must be found within the limits of a balanced budget until they can find and we have helped them to find the transition to sectors "a" or "b."

I deny that our rapidly, progressively increasing additional production is automatically converted into corresponding additional consumption or investment. I deny that any theory or practice except war or similar compulsory production has yet found the way to this conversion. To find the way, while safeguarding the freedom of the individual, is the most important task of this generation and perhaps the next. We have to find it through the highest concerted effort of industry, labor, and the administration. This country, with its unparalleled productive ingenuity, will struggle to find the way to employ all our citizens usefully. In the meantime, owing to this wartime production miracle, it is evident that American industry, agriculture, and labor working in a sympathetic political climate can undoubtedly provide a decent living for everyone in the United States.

## DISCUSSION

E. G. NOURSE: With the formal "conclusion" of Professor Beckman's paper, I am in very full accord. There, he takes the position that the problem of the little businessman after the war is not large-*versus*-small business but large-*and*-small business "both thriving and prospering in an atmosphere conducive to the maximum welfare of society." But this sound and well-balanced view is not maintained throughout the paper. At several places, the author lapses into defense of small business, without making the needed discriminations between the operative or organizational situations in which small units are easily established and easily maintained and those whose technical requirements preclude easy entry and make small-scale operation impractical. Failing to emphasize this distinction, he gives us a rather conventional and, in my judgment, somewhat sentimental eulogy of small business as such.

In his opening paragraph, he says: "A truly competitive economy is *necessarily predicated* upon the continued existence of small business enterprise. In fact it presupposes the *prevalence* and *dominance* of such enterprises in order that no one or any group of them will exert any appreciable influence on output, price, or the market." Later, he adds: "Competitive capitalism insures freedom of enterprise, freedom to enter business, to grow, to achieve, even to fail. It provides an outlet for individual creative impulses and abilities and a livelihood for a large segment of the total population." Here the use of the terms prevalence and dominance seems to overlook completely the very large areas of metallurgy, railroad transportation, hydro-electric power, heavy chemicals, and synthetics into which individual creative impulses and abilities could not possibly enter through the channels of small business but in which individual talents get adequate facilities with which to work, adequate opportunities for both security and advancement, through the agencies of big business.

I differ with Professor Beckman and the school of thought with which he here aligns himself on both socio-political and economic grounds. As to the former, he says:

> Small enterprise is truly the backbone of American community life. Its owners and their families constitute the great middle class in our society, exert a stabilizing influence on our social order, and help to preserve a democratic society. They are also the local civic leaders; they own their homes, and support local institutions and organizations. Small business often makes for "ownership with responsibility, or ownership with a 'conscience.'"

Now I submit that the solid middle-class virtues are quite as well supported by the great mass of wage and salary earners in the $2,000 to $6,000 bracket who administer their domestic affairs carefully to provide their families with automobiles, electric washers and refrigerators, college educations, insurance, and a house in the suburbs, and who accumulate a few corporate stocks and government and corporation bonds, as it is by the farmers and small businessmen who have a comparable financial stake in, but often a precarious hold on, the proprietorship of the business in which their labor is applied.

I grant that "small business often makes for 'ownership with responsibility or ownership with a conscience.'" But likewise, large business also often makes for a commensurate sense of responsibility on the part of executives

for the still larger numbers of people and the greater social interests trusteed in their hands. Socially adjusted people in small business have a broader vision than do the "public be damned" boys in big business; but, by the same token, the economic statesmen in big business positions have more conscience and responsibility than the Scrooges among small businessmen.

In its economic aspect, I challenge the idea that competitive conduct is necessarily limited to businessmen who administer enterprises so small that "no one or any group of them exerts any appreciable influence on output, price, or the market." Elsewhere, I have expounded the view (*Industrial Price Policies and Economic Progress*) that the competitive "battle of the giants" may be and often is keener and more effective than any competition that could, in those areas of business, be injected by small operating units. Does anyone suppose for a minute that the continuance of several hundred automobile manufacturers or some eight or nine score tire manufacturers or the great mass of independent grocery stores would ever have initiated the kind of effective competition which has been injected in those fields by Henry Ford, Harvey Firestone, and the Safeway Stores? The fact that small business furnishes a satisfactory pattern of atomistic competition for certain economic fields by no means proves that this kind of competition could solve the problem in other industrial areas. Nor does it indicate that something as good as, or better than, that kind of competition may not be consciously, purposefully, and skillfully put into the operation of these other industries by the executives of the large units invited, if not demanded, by the technological requirements or opportunities characteristic of these other areas of business life.

In spite, however, of Professor Beckman's opening premise that only small-scale competition is real and effective competition, he progresses to the position that there is a proper sphere of big business activity articulated with or complementary to the operations of small-scale types of business. I concur heartily in his conclusion that the issue is not one of large-*versus*-small business but is rather a matter of the harmonious and complementary roles of large-*and*-small business in a well-ordered industrial economy. I should have been glad to see this theme developed more fully in the paper by pointing out the places at which large units of business management and co-ordination are called for as well as points at which small units of operation tend to persist and even to show superiority. In this connection it should be recognized that our customary ways of classifying organizations as large or small often ascribe separate business identity to small operating concerns which are in fact tied to larger organizations, on which they are highly, if not completely, dependent as to market outlet, financing, pricing, or other matters.

Further important issues should be raised as to the possibility of continuing a high degree of operative independence and still securing the efficiencies of large-scale specialization in the performance of particular functions such as supply purchase, financing, research, use of heavy equipment, and sale of product. This sort of interpenetration of smallness as to entry, exit, and current operation and bigness as to certain overhead functions is illustrated by the co-operative association and federation, the voluntary store chain, the

trade association, and the use of large numbers of exclusive contract suppliers by large fabricating or assembling companies and mass distributors. In a word, economists would do well to study a little more political science or to team up with political scientists in order to get a more realistic picture of the scheme of governance which provides the institutional setting of business organization through which economic forces operate and may be conditioned.

Statistical studies of "big" and "little" companies based on number of employees, value of assets, or volume of sales give us arbitrary classifications that put functionally unlike things in the same quantitative boxes. On the other hand, the political scientists' qualitative concepts of sovereignty, local autonomy, delegated and reserved powers; empire, dependency, colony, and "sphere of influence"; equitable suffrage and apportionment of representation —these and many others should prove really helpful in analyzing and improving the actual operations of our industrial and financial system.

Mr. Yntema presents an illuminating and well-balanced view of numerous constructive and co-ordinated approaches to the better adjustment of the working economy. Public policy and governmental activities are thoughtfully articulated with the policies and activities of private business enterprise. When I get to the end, however, I feel that I have seen a beautiful presentation of Hamlet from which the Prince of Denmark has inadvertently been omitted. At several places there were cues which seemed to me to announce the entry of the noble Dane, but he never actually makes his appearance. All this is to say that Mr. Yntema gives no attention and apparently attaches but little importance to the factor of voluntary pricing for full-volume operation, which to my way of thinking is one of the crucial elements in maintaining high-level employment under a system of private business. Specifically, he says: "In business there must be . . . as much competition as is consistent with the economies of large-scale production." And later in the same paragraph: "Unless the trend toward monopolistic organization in business, labor, and agriculture is reversed, the system will have small chance of operating for long at a high-production, 'full'-employment level."

From this, which is so largely true, I have just one specific dissent. I think the "economies of large-scale production" inevitably give us business organizations that are fraught with monopolistic or monopoloidal power, and particular groups, notably labor and agriculture, have been constrained to build up organizations of great strength to defend their respective interests against previous aggregations of power in other fields. It is impossible and perhaps not desirable to unscramble these organizations. Hence the issue seems to me really to focus on the quality of the thought that goes into the policy making of these power agencies or the use which they make of their ineradicable monopolistic positions. I would therefore rephrase Yntema's statement, "In business, there must be as much competition as is consistent with the economies of large-scale production," to say: In business the *use made* of the monopolistic power of the agencies required for the attainment of economies of large-scale production must be designed specifically to achieve the high-volume, high-efficiency results that would be accompanied by atomistic compe-

tition in these fields, *if* atomistic competition could exist there without loss of technological efficiency.

Entertaining these views, I would also make a slight modification in the proposition contained near the end of Mr. Yntema's paper, "The role of individual businesses in counteracting business fluctuations is secondary, but they can help," changing it to read: The role of individual businesses . . . is primary, but government can help. However, in the interest of peace and that reasonable and objective further study of the problem by economists which Mr. Yntema bespeaks, I would settle for the formulation: The roles of individual business and of government are co-ordinate. Each can help the other.

The paper of Dr. Hirsch, likewise, seems to me to be incomplete by reason of its omission of reference to the role of industrial price policy in the period of postwar adjustment. I concur in his view that our postwar capacity to produce will be greater than most people are ready to admit—though I do not much believe in "miracles." But his fear that we cannot bring consumption up to a level compatible with that productivity seems to me to be a species of defeatism. If the flow of production is allowed to continue up to the level set by the number who want to work and the product priced to move into consumption, a high-employment, high-consumption economy will find a workable equilibrium. These are views which I have developed in detail elsewhere. The fear of deflation constitutes the real threat of less-than-full employment. But business cannot afford to use its unquestioned power to prevent the deflationary force of this productivity from expressing itself.

Chalmers Hamill: At the outset I should like to make it perfectly clear that in my discussion of Dr. Beckman's very able discourse on "Large Versus Small Business After the War," any observations, opinions, or conclusions to which I give expression are my own views, which may or may not be the views of the Department of Justice.

Dr. Beckman's opening sentences I interpret to mean that free business enterprise is recognized in America as one of the basic tenets of our economic, as well as our political, life and that our system of law recognizes it as a fundamental right. Whether the common law, as presently supplemented by statute, sufficiently defines that right or affords it adequate protection is a debatable question upon which Dr. Beckman throws unerring and penetrating light.

Up to June 11, 1942, the date upon which the Small Business Mobilization Act became law, I know of no legal differentiation between small and big business enterprises as such. Even in that Act, which was conceived for the very purpose of aiding "small business" to make its full contribution to the war effort, no attempt whatever is made to define small business.

Dr. Beckman's analysis of the problem involved in defining small business, therefore, develops fully the difficulty which has characterized every effort, with which I am familiar, to segregate a particular group of business enterprises under a designation of small business for the purpose of identifying them as potential beneficiaries of a proposed program. It is that very difficulty

which demonstrates the fallacy of any such definition or classification. The term small business has come into favor simply to express a contrast with so-called "big business," which term, historically, has been used to express the concept of aggregations of capital and enterprise resulting in the "trust," the monopoly, the cartel, etc. Small business, like big business, is a catchword. It expresses a current concept in the realm of enterprise, just as "a good egg" is contrasted with a "hard boiled egg" in the realm of management or control, whether it be civil or military. Actually, however, it has no place in a serious attempt to classify business enterprises for any scientific or technical purpose.

It will be noted that all of the criteria referred to by Dr. Beckman as having been used as bases for distinguishing small from big business find expression in strictly numerical and therefore wholly arbitrary terms. No definition of small business based upon such a criterion can be either comprehensive or accurate. I speak with some knowledge of the subject because the records of the Small Business Section of the Department of Justice show that at least 80 per cent of all the individual complaints which have been made to it have come from business concerns which have been hurt by just such an arbitrary classification, defined in some order, regulation, or directive of government.

If we must classify businesses into small and big, therefore, it would seem much more sound to avoid, if possible, the use of a criterion which has no relation to the objects and purposes of the classification.

Instead of such criteria as the number of employees, the amount of assets, or the volume of sales, a criterion of influence or power would seem to have the qualities of being related to the purposes of the classification and also of being flexible enough to comprehend individual cases. Small business, then, would become any business which is not, per se, illegal or contrary to public policy, whose position is not such as to enable it to fix prices, curtail competition, or restrain trade.

This criterion or basis for classification seems to assuage my anxiety for several reasons:

1. It is expressive of American ideas and standards. Dr. Beckman observed, for instance, "America is a big country and it has long been a firm believer in bigness."

2. While bigness has no right to be worshipped for its own sake, it has established a right not to be condemned as such. Very sizable concerns have been known to need help, financial or otherwise, to enable them to continue in existence. In his concluding words Dr. Beckman says: "Both large and small businesses have made notable contributions to the progress of this nation and of the civilized world, and both can continue to do so in the future."

3. Size is a relative term, dependent upon many factors and at any stated date is a product of the evolution of our American business psychology up to that date.

4. Any definition adopted as a basis for far-reaching and more or less permanent economic planning should be free from any arbitrary delineation which might serve to restrict rather than to enhance its effectiveness toward the desired end.

After the war all business will need:

1. Access to capital, both venture and investment money, on reasonable terms. This is a much simpler problem for big business than it is for small business.

For the originator, the creator, to get into business, he must ordinarily obtain venture capital. The difficulties involved in this operation are legion. To keep out of jail in the process requires the guidance of able counsel, both legal and accounting.

The banks, investment bankers, the better business bureaus, and the chambers of commerce are all zealous in their efforts to protect every dollar made available for venture capital. Many such institutions have come to regard all investment money as the exclusive domain of the so-called "legitimate" stock selling (underwriting) financial houses.

These financial institutions have in turn educated the public in the belief that only listed securities are legitimate investments, with the result that venture money for new businesses has almost ceased to exist except in the hands of those who require a controlling interest to induce any investment at all.

2. Safety afforded and preserved by a comprehensive, consistent, and continuous enforcement of the antitrust laws.

3. A reasonable degree of honesty, integrity, and responsibility in business ideals, ambitions, and operations.

In this connection, some institution should take upon itself the duty of informing businessmen generally, and ensuring the instruction of the future businessmen of the country, that the motto, "It's all right if you can get away with it," is really not a canon of American business ethics nor an axiom of any accredited school of economic thought in the field of business relationships.

# HOW ACHIEVE FULL AND STABLE EMPLOYMENT

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If we attempt to look into the postwar future of our economy, there are many uncertainties. There are some certainties, too, and one of these is general unemployment.

It is not intended to suggest that general unemployment is a malady of our system of private competitive enterprise which is incurable. It is suggested that we can be sure this malady has not been cured by accumulating the makings of a postwar business boom through deferment of civilian demand.

During World War I the flow of civilian goods and services was at a comparatively high level. After World War I several million persons had to be reabsorbed into civilian production. In spite of this, in the first decade after World War I, we enjoyed a period of persistent business boom. During most of this decade, business was aided by deferred civilian demand both domestic and external. Because this period was marred by several interruptions in the process of business expansion, particularly that of 1920-22, it was by no means free of unemployment.

This decade of buoyant business was followed by nearly four years of rapid business recession and then a much longer period of slow recovery with one sharp interruption in 1937-38. We might refer to this second decade after World War I as a period of relatively stagnant business. Certainly it was a period in which the volume of unemployment was intolerably large. Even by mid-1940, when our war production effort began, the number of unemployed was not far from as large as the wartime strength of our armed forces. Average unemployment during the two decades may be estimated at 6 to 7 million.

There is an important parallelism for our economy as between the two World War situations. Again today the flow of civilian goods is at a comparatively high level. And again we face a prospective problem of reabsorbing persons from war employments to peacetime employments. Measured as a percentage of total national output, our present war effort is two or three times that of World War I. The number of veterans and war workers to be reabsorbed into civilian production will be larger by some 12 million or more. Many of the war workers will be reabsorbed without changing their jobs by simply remaining at work in plants being reconverted to peacetime production. But the remaining problem of reabsorption will be a substantial one. Again as

[1] The views expressed by Mr. Copeland are his own personal opinions and do not necessarily reflect in any way those of the War Production Board.

compared to World War I, the greater and more prolonged war production effort means that there will remain also a much larger reserve of deferred civilian demand.

This much of the pattern of the total employment curve after World War I seems likely to repeat itself if we do not prevent it. There will be an era of relatively buoyant business while the deferred civilian demand is being met, an era in which business recessions will be short; after that there will be an era of relatively stagnant business in which the average volume of unemployment will be substantially larger than during the period of buoyant business. Either of these two eras may be longer or shorter than a decade. And in either era the volume of unemployment may be more or less than it was in the corresponding era after World War I.

Factors other than the employment level from which we start, the volume of war labor to be reabsorbed, and the volume of deferred civilian demand will affect the pattern of the total employment curve for the postwar period ahead. Among these are factors suggested by the "secular stagnation hypothesis." One need not accept that hypothesis in its entirety to recognize and accept two of its corollaries: first, that on balance the development of our economic system in recent years has probably been such as to aggravate the problem of unemployment; and, second, that business fluctuations over a period of a decade or more may take place on a level such that even peak employment is considerably below full employment. Each of these corollaries may be commented on.

First, in what respects has the development of our economic system aggravated the problem of unemployment? Several aspects may be selected for comment. Not only has our frontier gone, but there is also relatively less of rural semi-self-sufficiency. A smaller proportion of our population today is in a position to withdraw from the price economy when it fails to work than was the case even a generation ago. As this development has cut off the possibility of self-help, however unsatisfactory that may have been, the need for public unemployment relief has become more urgent. Again durable goods and construction represent a percentage of total output that has an upward long-term trend; and business fluctuations in these types of production are notoriously wide. Further, there are more inflexibilities in our scheme of organization than formerly, especially inflexibilities which tend to maintain the costs of capital goods during business recession. Moreover, there has been some further gain during the past twenty-five years in the relative importance of the replacement demand for capital goods, and this type of demand is less expansive than the initial demand for capital goods when an economy is newly equipping itself. Both because the type of

demand is less expansive and because maintained costs are a deterrent, we can hope for less help in recovery through the rapid expansion of the demand for capital goods. Hence our economy today is probably less resilient in its ability to recover from a depression.

What of the second corollary, that business fluctuations may continue over a period of a decade or more on such a level that peak employment is considerably below full employment? The truth of this proposition was demonstrated by our experience in the thirties. There can be little doubt that the peak employment reached in a period of business expansion may be substantially less than full employment. The significance of this second corollary of the stagnation hypothesis is that we may well be able by appropriate public measures to attain stable employment without thereby attaining full employment. There is need to consider separately how to achieve stable employment and how to achieve full employment. The recognition of these two separate problems as separate problems is an important step forward.

These considerations suggest that unemployment during the next fifteen or twenty years is not likely to average less than it did in the comparable period following World War I. However, this is one side of the picture.

On the other, it may be pointed out that, because the volume of deferred civilian demand will be much larger than after World War I the period of buoyant business should last somewhat longer; and while the number of persons to be absorbed into civilian employment is much larger, too, this does not necessarily mean that the period of buoyant business will be on a lower level than in the twenties. Further, it may be argued that the large volume of unemployment in the thirties was the result of a combination of many circumstances and that it is unlikely that this peculiar combination will recur when we reach the period of relatively stagnant business, after the deferred demand is satisfied; hence that it is unlikely that we shall have a volume of unemployment in that period comparable to the volume in the thirties.

Further grounds may be cited for optimism. Three important public measures have been taken since 1929 which should help to moderate business fluctuations: (1) federal regulation of the marketing of securities; (2) insurance of bank deposits; (3) unemployment insurance. The first two measures are designed to avoid specific forms of financial crises. Unemployment insurance provides a partial maintenance of income for a limited benefit period during unemployment and helps to the extent of the benefits to sustain purchasing power. While these measures will hardly prevent business recessions and depressions, or provide that the level of employment in periods of business prosperity shall approach the level of full employment, they should serve to decrease the severity of business fluctuations.

It will be convenient to refer to the considerations just set forth as exemplifying two schools of thought—the optimists and the pessimists. According to the pessimists we may look forward during the next fifteen or twenty years to an average volume of unemployment of 7 or more million. But even an optimist, if he is candid, will look for a volume of unemployment that will average 3 to 4 million—roughly 2 million man-years of seasonal and between-job unemployment, a million man-years of cyclical unemployment on the average during the period of buoyant business, and, during the succeeding relatively stagnant period, 2 to 3 millions of cyclical unemployment plus unemployment even at the peak of business activity. Both forecasts assume that we do not take substantial new measures against unemployment.

It is not our present purpose to determine whether the optimists or the pessimists are right. On either view the prospective volume of unemployment is cause for grave concern. We will face tomorrow a question that yesterday we could lightly dismiss as academic: Is private competitive enterprise so much more desirable and efficient than collectivism that we can afford to waste 5 to 10 per cent of our resources each year? Economically this question is made stronger by the fact that the prospect of so much idleness in many devious ways diverts our energies from production to means of "making the work go around"—restrictions on output in labor attitudes, in collective bargains, and in legislation, stoppages, competitive duplication in business facilities and operations, the development of monopolistic competition and competitive sales effort, patronage and the pork barrel. Politically this question is reinforced by the fact that a disproportionate number of the unemployed may be veterans. If so, we may be sure the unemployed will make themselves heard. The opportunity to see how collectivist industrialism operates in Russia during the peace to come may quite possibly help to convince us we should answer our question in the negative. We cannot afford the waste of resources that general unemployment involves.

When we ask how we can remedy unemployment within our system of private competitive enterprise and what are its causes, we find agreement among economists on the first step in causal analysis. Seasonal unemployment and between-job unemployment, on the one hand, and cyclical and peak-business unemployment on the other can be treated separately. What follows is concerned exclusively with the latter phases of the problem.

Beyond this first step in the analysis of causes the situation presents a paradox. On the one hand, there is wide disagreement as to the basic causes both of business fluctuation and of the failure to reach full utilization of our resources even during prosperity. Writers have sought the causes variously in the maldistribution of income and the failure of

corporations to distribute all their earnings, in the movements of interest rates, in changes in price margins, in monopoly, in the acceleration aspect of the derived demand for capital goods, in the short-term labor contract, in miscalculations by businessmen, in financial chicanery, in monetary and fiscal mismanagement, in technological change, in the relation between population and natural resources, in the opening up of new territories, and even in sun spots.

On the other hand, in spite of the diversity of views on ultimate causes of cyclical and peak-business unemployment, there is some measure of agreement on major proximate causes of business fluctuation. There is some measure of agreement, too, as to several important forms of public action available to deal with business fluctuation and stagnation, and as to the effects that may be expected of these measures. Fortunately these matters on the whole rather than ultimate causes are pertinent to the question of remedies.

Four proximate causes, on which there is a fair measure of agreement may be noted:

First, year-to-year fluctuations in the orders for durable goods and construction work contribute to business fluctuations. (a) During a depression much of the demand for capital goods is defered, thus diminishing the volume of business during depression. (b) At the turning point the swelling of demand for capital goods when deferment stops may contribute to recovery. (c) During prosperity the demand for capital goods may be swollen not only by deferment but also *by anticipation*. (d) At the turning point exhaustion of the source of swollen demand for capital goods may help to bring prosperity to an end. (e) During depression again the more there has previously been of forward buying of capital goods, the greater and more prolonged the subsequent decline in demand for them.

Second, inventory variations contribute to business fluctuations. (a) During recession liquidation of inventories decreases demand for the goods in the inventories. (b) At the turning point stopping inventory liquidation tends to increase demand. (c) During business expansion inventory accumulation increases demand. (d) At the turning point stopping inventory accumulation tends to decrease demand.

Third, business expansion is a favorable environment for the development of unsound financial structures, narrow residual equity structures and operations that with even small market changes may involve financial distress—bankruptcy or receivership. Such financial distress in turn may cause unemployment and thus contribute to a recession or to its inauguration.

Fourth, the informational bases on which businessmen make commitments and the diagnoses of business prospects on which public officials base policy are inadequate, particularly in the areas of durable goods production, construction work, and inventory variation. This inadequacy contributes to the amplitude of business fluctuations.

It may be urged that to these four proximate causes we should add a fifth major proximate cause of business fluctuations and business trends—variations in external trade balances. No question is raised here as to the reality or the importance of this fifth factor. However, for our present purpose it will be passed by on the ground that so large a country as the United States cannot manipulate its external balances to stabilize business or to support a high level of business activity without unfortunate international repercussions.

So much for proximate causes; next as to forms of remedial action. Some of these, when taken, are of a continuing nature: improvements

in business information, modifications in our tax structure and our financial structure, etc. Except for improvements in information it can hardly be said that there is much agreement on these more general forms of action and on the effects to be expected from them. No discussion of them will be attempted here. Other forms of remedial action require to be taken (or aimed) at an appropriate juncture in the development of the business situation. In general, these latter forms may be used in either of two ways: as checks and as stimulants. Three of such forms of remedial action may be considered: (1) credit controls, (2) tax and subsidy policy, and (3) public expenditure programs.

1. Hitherto the chief usefulness of credit controls has been in checking an overexpansion of business. For this purpose they need to be promptly resorted to. Except as credit has been a means of financing public expenditure programs, credit policy has not proven very effective in stimulating business expansion during recession, or in stimulating a rise in the level of business volume when there is peak-business unemployment as well as cyclical unemployment.

2. In theory, adjustment of the tax level is possible both as a means to discourage business overexpansion and as a means to encourage expansion when encouragement is needed. However, if any such adjustments are to be useful they must be promptly made; some way must be developed to make the necessary adjustments through administrative action rather than by legislative process. Such adjustments today are painfully slow.

But there are other uses of tax policy that for the most part avoid the problem of administrative adjustment. Specific tax differentials can be enacted, designed to check specific forms of business overexpansion or to penalize formation of specific unsound financial structures. Specific incentives to business expansion during depression and specific incentives to improved business information may be provided through tax differentials, through tax rebates, or through subsidies.

3. Public works and other public expenditure programs are chiefly useful for the present purpose as a business stimulant. They can be used as a check on overexpansion, also, when the occasion requires a check, to the extent that the volume of programs in operation can be cut back.

At present the use of public action as a check on business expansion is in disfavor. A boom of vast proportions is in prospect—in housing construction in spite of the original plan of the FHA, in commercial structures, in automobiles and many other durable goods, in goods for relief and rehabilitation, even in public works.

The tendency to find in the current level of business a new secular trend is prevalent again. This peculiar form of historical myopia ap-

pears to be chronic. The present attack of historical myopia transmutes items of additional business that will contribute to a boom into measures that will help permanently to solve the unemployment problem. One widely accepted approach to the problem is the seeking of enlarged postwar markets by business. Another is the planning of as many public works as possible to be carried out as soon as relaxation of wartime restrictions permits and without provision for scheduling them with reference to business conditions. It is easy to foresee the boom and fail to foresee the end of the boom when deferred civilian demand is exhausted.

Applying checks to business expansion is never popular. Today its unpopularity receives theoretical backing from two opposing trends of economic thought. Many of those optimists who have as a postwar objective "less government in business than we had in 1939" will be likely to oppose the use of checks on business expansion as a form of unneeded government interference. There are also opponents of the use of checks among the pessimists and planners. They are concerned about the possible extent of unemployment during reconversion and are opposed to vigorous use of checks on the ground that peacetime booms have never yet achieved full employment. But at the worst, unemployment during the reconversion period is likely to be a short-lived interruption to the boom.

In spite of this strange agreement between advocates of laissez faire and advocates of economic planning it is submitted that there is serious danger that too big a boom during the postwar period of buoyant business will lead to another 1929. The employment of checks during the peacetime boom ahead is urgently needed. But there is reason to oppose checks, as checks have too often been conceived in the past. Heretofore some have held that we should seek to identify some instant in the boom period at which business expansion becomes overexpansion, and then, having identified it, proceed simultaneously to tighten credit, to raise the tax level, and to curtail public expenditure programs. But general business expansion can never be overexpansion so long as we fall short of full employment. Checks should not be applied to the total volume of business to remedy specific trouble spots. We need not burn down the house to roast the pig. The need is for a selective employment of checks. The selection of checks and areas of application should be made in terms of the proximate causes of business fluctuation, and the checks should be tailored to the factors on which they are to operate.

Checks are needed for two main purposes: (1) to prevent the development of unsound financial structures and operations, and (2) to

prevent the forward buying and overaccumulation of durable goods and to prevent overconstruction during a boom.

The first of these purposes requires early identification of unsound financial structures, early identification of business that is trading on too thin an equity. Because of the variety and continual change of financial organization, early identification of unsound structures when only a few have developed is by no means easy. Each major boom is likely to bring forth new forms of unsound financial structure. The remedy must vary with the varying form of unsound structure with which it has to deal. There may be need for public regulation of the terms on which specific types of credit are extended as well as of their rates. Specific financial and sales practices may need to be prohibited. And besides preventing the organization of additional structures that are unsound, there will be need to reorganize those already formed. Immediate stopgap action is likely to be required, pending the time when specific statutes can provide more lasting measures.

This outline of the task of providing specific checks to prevent the development of unsound financial structures raises a question as to the adequacy of the existing authorities and responsibilities of federal agencies in the credit field. In spite of their broad scope there is need for a careful survey to determine what additional authorities and responsibilities should be vested in some federal agency or agencies, or what residual, emergency authority and responsibility should be vested in some one agency, if the necessary stopgap actions are to be taken promptly, when trouble appears in some new and unexpected form.

The second major application of checks is to restrain overconstruction and overaccumulation of durable goods. Before considering this application certain broader aspects of our problem should be noted. Consistent with our system of private enterprise there are two main approaches to the problem of eliminating the cyclical fluctuations of business. (1) Unsound financial developments may be prevented and we can seek to stabilize the production or sale of those goods that fluctuate most by offering incentives when business is slack and applying checks when the volume is too large. (2) A sufficient volume of public construction and other public programs[2] may be scheduled as compensatory expenditure programs. The second approach commends itself as involving the lesser modification of our free enterprise system. But if the compensatory expenditure approach is to be relied on alone, the volume of projects must be adequate. At the very least it would be

[2] Such expenditure programs include census-taking, theater projects, unemployment insurance benefits, agricultural benefits, relief, etc.

necessary to be able to expand or contract the annual rate of compensatory expenditure by as much as 10 or 15 billion dollars and to accomplish an expansion of this magnitude within a period of a year on a time schedule determined in the light of the business situation, if we were to rely on this approach alone.

Thus far our efforts at compensatory expenditure programs have been "too little and too late"—far too little and far too late. There are two main possible methods of expanding the volume of public programs available for compensatory purposes, in addition to the objectionable one of made-work. (1) We can find some way, acceptable to state and local governments, of including state and local projects. Under present conditions they are not only not a part of a compensatory expenditure program, but they are even a part of the unprogrammed area that tends to augment the cyclical fluctuations of business. (2) The federal government can invade the present field of private enterprise far enough to get the necessary expansion. Even if we find ways to incorporate state and local government projects in the compensatory expenditure program, a large further addition to the program would be needed. It would be very doubtful that nationalization of the common carriers and the public utilities would suffice. Too large a part of their work and of the work of government is difficult to defer or to do ahead of time; hence too large a part is difficult to expand and contract for compensatory purposes. Clearly it is advisable to combine the compensatory expenditure approach with the approach of a system of checks and stimulants designed to stabilize specific forms of business fluctuation, a program that will decrease the amount of compensatory expenditure needed. If we desire to retain as many of the advantages of our free enterprise system as possible we will scarcely make the increase in volume of government compensatory expenditures an excuse for the wholesale taking over of industry.

Let us consider what is involved in the checks and stimulants approach as applied to any type of private construction or to the production of any durable good; e.g., public utility construction. The general plan of a system of checks and incentives is clear. Checks should be applied to decrease the volume of utility construction (to continue our illustration) during the peak period, possibly some form of peak-volume tax, possibly some method of tightening up on the extension of credit, possibly other devices. And incentives should be provided to increase the volume of utility construction during the low period—special advantages in obtaining credit, tax rebates, or even outright subsidy. The aim of these policies should be to influence the timing of utility construction. No over-all encouragement or discour-

agement to utility construction over a period of years need be involved to iron out the fluctuation.

As a basis for the system of checks and incentives there is need for a clear public determination on a current basis as to what volume of utility construction can be supported by existing and expected demand with year-to-year stability. This would involve forecasting the trend of demand. Such a current determination alone would make an important contribution to general business stability.

As applied to the problem of inventory liquidation and accumulation the system is primarily one of incentives rather than of checks. If liquidation during recession can be prevented most of the disturbing effects of subsequent accumulation will be avoided. Preventing general inventory liquidation during recessions is a problem of providing an adequate inducement to hold onto inventories, without giving incentives to overaccumulation and without restraining desirable inventory liquidation in individual cases.

Some steps have been taken toward such a system of checks and incentives in the field of residential construction. And various credit checks are at hand in other areas that could be used as part of such a system. But we have made no serious attempt on a broad basis to determine how much can be accomplished toward stabilization of business and employment through a system of checks and incentives in the fields of private construction, durable goods production, and inventory variation.

It has been urged that it is important to distinguish between the problem of business stabilization and the problem of full employment. For the latter objective there is little need for checks. The mechanisms of incentives to induce additional private business and of public expenditure programs are the chief recourse. But there is a difference in the projects and in the forms of incentive that can be used. Works projects can be added to the compensatory expenditure program by transferring them from an area which augments cyclical fluctuations, provided only that arrangements can be made for their proper timing. State and local projects illustrate the point. It is not so clear that projects can be retimed to raise the trend of the level of business activity. For this purpose it may be necessary to plan projects that will constitute a net addition to the total volume of business, projects that would otherwise not have been planned at all. Similarly with incentives. A change in our tax structure that encourages one type of private business rather than another needs be distinguished from one that raises the trend of the level of business activity by inducing private business that otherwise would not have taken place at all. Again, for works projects

designed to compensate cyclical fluctuations the case for recourse to deficit financing is fairly strong. But when it comes to projects designed to raise the trend of the level of business, the case for deficit financing is anything but clear.

These distinctions are easier to draw in theory than in present practice. So long as we have business cycle fluctuations of substantial amplitude, there is likely to be danger of confusion between business stimulants that augment business expansion in a cyclical sense and business stimulants that help to raise the level of the trend of business activity. It is often difficult to tell when an addition to business today is a net addition to total business, and when it is gained by borrowing business from the future and so by borrowing trouble.

To indicate more clearly the distinction between these two types of business stimulants, let us assume that measures have been taken to prevent development of unsound financial structures and that we have a system of checks and incentives designed to iron out much of the fluctuation in durable goods production, private construction, and inventories. Let us consider the problem of managing public expenditure projects under these conditions.

Public expenditure projects will be needed (1) to stabilize the total volume of business activity and of employment by compensatory expenditure, and (2) to promote a high level of employment and business activity. Both purposes require that the volume of public projects to be started in any period be controlled centrally and with reference to the business situation. Fortunately this means determining centrally how many projects are to be carried out in a given period. For state and local projects at least, it does not mean determining in detail what projects are to be carried out, or in what order they are to be undertaken.

Two questions involved in the management of expenditure programs may be considered: How many projects are to be undertaken in a given budget period? What budgeting period is to be employed?

The second question is the simpler. A year is too long a budget period to deal with business fluctuations; a month is too short a period for administrative reasons. The choice is between a quarter and a half-year. Let us assume the half-year is the budget period. This does not mean that projects will have to be planned on such short notice. A part of the budget of expenditure projects for several half-years into the future can be definitely made up—new projects to be begun as well as projects underway to be carried forward—provided that the future level of business activity can be roughly forecast and the need for expenditure programs partially determined. But some projects will need to be planned and approved, and ready to go on short notice if needed, or

ready to be deferred if they are not. If works projects are to be used to prevent cyclical and peak-business unemployment, it is essential to have a file of such stand-by projects. The extent to which projects can be planned and scheduled ahead for a definite period will be limited by the degree of accuracy with which the volume of business activity can be forecast.

The question of how many projects should be started during a half-year may be considered, first, with relation to stabilization as an objective, and, second, with relation to full employment as an objective. For both objectives it will be convenient to think of the gross national product as consisting of two distinct segments: (1) scheduled public expenditure projects, including the work of contractors and subcontractors on such projects; (2) other ultimate government services and all private business activity except that included under "1." For convenience we will refer to the first segment as "scheduled production" and to the second segment as "free production."

Let us assume that a half-year's budget for expenditure projects included in scheduled production is under consideration, when the current rate of production (both segments considered together) is at least equal to that in the preceding half-year, but is somewhat short of full employment. The first budgeting step will be to estimate, on the basis of the present business situation and known commitments and trends, the volume of free production during the coming budget period, and to note the volume of scheduled production already definitely scheduled for that period.

The immediate question for purposes of stabilization then is, how many additional public expenditure projects are needed to bring the level of total production during the coming half-year up to the present level? The longer-run question is, is the estimated volume of prospective projects of types now classed as scheduled production at least equal to the volume likely to be needed during the next several periods? If not, what projects now included in production can be reclassified as scheduled production so as to provide an adequate volume of scheduled compensatory expenditure projects? Or, alternatively, in what ways can the system of checks and incentives be extended so as to reduce requirements for scheduled production?

But if the current volume of employment is somewhat short of full employment, more projects should be scheduled than just enough to maintain the volume of business. For the objective of full employment, three budgeting steps are indicated: (1) to determine what surplus of prospective expenditure projects, if any, over and above compensatory requirements is available to raise the level of the trend of total business activity; (2) to plan and instigate additional public expenditure projects

so as to provide such a surplus, if necessary, or alternatively to provide incentives to additional business in the area of free production; and (3) to schedule the surplus so that it will raise the level of business activity and at the same time to provide for replenishing the surplus through planning additional projects, so as to avoid the danger that the level of business activity will be lowered again by exhaustion of the surplus.

This outline analysis of how scheduled production public expenditure projects might be budgeted with reference to the business situation provides no a priori determination of a fundamental issue: what will happen to the level of business activity, if cyclical fluctuations are eliminated? On the one hand, will the level tend to rise to full employment in the course of a few semesters? Will the scheduling of surplus expenditure programs at a constant rate per semester accelerate the rise? Affirmative answers to these questions might be phrased as a rejuvenated Say's Law. On the other hand, will a stabilized level of business activity tend to perpetuate itself? Will the scheduling of surplus expenditure programs at a constant rate merely raise the level by the amount so scheduled per semester plus an eventual fixed multiplier effect?

If no a priori answer is offered to these two alternatives by our analysis of the scheduling of public expenditure projects, the method for obtaining an empirical answer is clearly indicated. If the outlined plan of budgeting public expenditure projects were followed, a rapidly accumulating addition to the surplus of prospective expenditure projects would indicate that the former questions should be answered in the affirmative. Absence of such an accumulating surplus would substantiate the stagnation hypothesis. One thing we can say a priori: these two are not the only possible alternatives. The question involved is one of degree.

The method for obtaining an empirical answer to another question is provided. When is an addition to the volume of business today a net addition? When is it gained by borrowing business from tomorrow and borrowing trouble? If replenishment of the file of plans for future projects is co-ordinated with the schedule for putting projects into operation during the next few half-years, we are not borrowing trouble.

Our analysis of how scheduled public expenditure projects might be budgeted with reference to the business situation suggests two further conclusions: (1) If we mean seriously to deal with the problems of cyclical and peak-business unemployment through public expenditure programs, we shall need to develop and put in practice a budgeting procedure for public projects somewhat like that outlined above. Mere encouragement of a fad for planning public works is not enough. There is need for a continuing quantitative determination of how many proj-

ects need to be planned and planning the number determined on. There is also need for determining how many should be scheduled each half-year and for scheduling the determined number. (2) Such a budgeting procedure will be made easier to operate and more effective in proportion as we are able to improve our forecasts of business activity in the area of free production.

Thus far we have considered only three of the four factors we have listed as proximate causes of business fluctuations. It remains to consider the fourth proximate cause—the inadequacies of present business information—and to consider what improvements in information are most needed. Much progress has been made in the past twenty-five years in providing current business information. Indeed most of what we have today on a semiannual or more frequent basis has come into being in that period. There are important gaps and defects in that information still, but our major need is not for additional current data, but for better business forecasts, especially for better forecasts of free production. Much progress has been made, too, in the art of business forecasting, but much more remains to be accomplished, particularly in the area of durable goods production, private construction, and inventory variation. The types of development needed are clearly indicated. They are types of development in which there is need for private enterprises and individuals and public agencies to participate and to cooperate. There is need that each separately should do more and better forward-planning, and planning farther into the future. There is need, too, for firming up these plans, so that we can be assured, by and large, that when adopted, they will be carried out. Again there is need that each should make his plans available to some central agency so that these separate plans may be combined into a total forecast. In a word, what we need is a consolidated national production schedule for a year or more into the future for our whole economy.

## DISCUSSION

John H. G. Pierson: I am somewhat puzzled as to whether Dr. Copeland thinks the problem can be solved, inasmuch as his paper includes references to the "certainty of general unemployment," the "likelihood" of as much unemployment as in the interwar decades, etc. Surely by now we can agree that it must be solved, and get on to studying the implications of the alternative solutions. Dr. Copeland submits that we probably cannot afford the waste of unemployment, especially because of competition from the Soviet Union. But the case should be put even more strongly. If any considerable unemployment develops in the United States, the resulting pressures will not only poison our whole relation with the Soviet Union, unsettle Anglo-American intercourse, and give a somewhat sinister tone to our foreign relations generally, but will also dangerously intensify group conflicts here at home.

With much of Dr. Copeland's diagnosis of the problem I am in cordial agreement. Deferred demand cannot provide a full solution. Stabilization of employment is not enough, since the stabilization point might lie below full employment. (Hence, incidentally, we need more than cycle theory in the strict sense to cope with this question.) Certain recent changes have affected the general economic environment in ways that make it more difficult to avoid unemployment; for example, the passing of the frontier, the loss of rural semi-self-sufficiency, growing cost inflexibilities, a shift toward more replacement and less innovation in our capital formation. On the other side, as he points out, such developments as the SEC, FDIC, and unemployment compensation now tend at least to keep the bottom from falling out entirely.

Dr. Copeland's estimate of the numerical magnitude of the postwar labor reabsorption problem seems about right. Possibly he is a little on the high side when he speaks of 12 million more than after World War I. At any rate we might in favorable circumstances find that our problem consisted, in net terms, of 5 million dismissed from manufacturing, 1½ to 2 million from government service, and 9 million from the Army and Navy—or, say, a net total of 16 million before deducting several million who might return to college, the home, etc.

On the other hand, I feel that Dr. Copeland may have underestimated the real difficulty of achieving his initial period of "relatively buoyant business." Of course this is bound to depend in very large degree on whether the war ends abruptly or tapers off in such a way as to permit considerable reconversion to take place before the armistice. The extent to which export markets will be bolstered by foreign lending is another important question to which no answer is as yet available. Recognizing that these unknowns make any statement likely to turn out wrong, and agreeing with Dr. Copeland that boom tendencies will undoubtedly appear as a result of war savings and deferred demand, I am still by no means confident that these boom tendencies in certain markets will be generalized throughout the economy. The parallel with World War I has this important qualification, that this time we had 8 or 9 million unemployed before the war came along. Moreover, although the accumulated savings this time are very much greater, it should be recalled that,

when factory hours are cut from 48 to 40 with overtime eliminated, a factory worker will take about 23 per cent less pay home at the end of the week (assuming he keeps his job at constant hourly rates and is not among the 5 million squeezed out by demobilization of war production), which raises some question about the ready spending of any savings that he, at least, may have salted away.

Dr. Copeland's recommendations with respect to selective controls—notably, to dampen fluctuations in durables, construction, and inventories, and to prevent development of unsound financial structures—certainly deserve serious consideration. I shall limit my comments here to three suggestions. First, more stress might well have been laid on the necessity to combat monopolistic price restrictions. Second—and I shall return to this in a moment—it may be that, in spite of the undoubted necessity for certain selective or particularistic controls, the problem of selective controls in general would become somewhat less important if our over-all or general economic controls were adequate. Third, such individualized control as is implied by Dr. Copeland's plea for a "firming up" of businessmen's plans, to the end that we can be sure these plans will be carried out, seems to me something of an anomaly in a program that in other respects envisages minimum interference with private enterprise. Will not the businessman hesitate to sign on the dotted line? Or, if he has to submit his plan, and knows that he must keep it "firm," why should he commit himself to more than a cautious minimum?

The most important issues of all are those connected with the over-all controls, or general system of measures to sustain and stabilize employment. Dr. Copeland proposes that we combine a system of incentives and checks with compensatory public expenditures. Identifying the latter to all intents and purposes with construction and other public employment projects, and pointing out the necessity for an ample shelf of ready projects, central control over timing, and a system of budgeting by short time-periods, he calls attention to the difficulty of finding enough projects—outside of "make-work" categories—even assuming that state and local projects are properly co-ordinated as to timing and that the common carriers and public utilities are nationalized. This leads him to stress the importance of the checks and stimulants, to minimize the necessity for projects. He would apply these checks and stimulants, however, to the stabilization of specific forms of business fluctuation; for example, to the utilities, or the automobile industry.

I should like to suggest that this problem can be better solved by having the government underwrite aggregate consumer spending, thus leaving the individual industries free to compete for a market sufficient to maintain a normal profit on the average at levels of operation that add up to national full employment. Time is lacking to discuss this proposal at length, but in essence its effect on public expenditures for actual production would be to limit them to investment expenditures considered worth while for their own (rather than employment's) sake, plus expenditures for fill-in projects when and as required in spite of existence of the inducement to private enterprise afforded by the over-all guarantee of effective demand in the private consumer market. This arrangement would avoid the difficulties of a massive (and, in

principle, unlimited) public investment program, which would be likely to require uneconomical allocations of labor and other resources and would almost certainly not prove feasible politically. Definition in quantitative terms of normal frictional unemployment would be necessary, as for any full-employment program. Administrative control over subsidies and taxes, for adjustment of total consumer spending up or down, would probably be required, as suggested by Dr. Copeland in another connection. It should be noted, however, that consumption subsidies would be called for only in case of oversaving, and would not be needed if the optimists to whom Dr. Copeland refers are right in supposing that adequate demand will be forthcoming automatically.

# ECONOMIC THEORY IN RELATION TO THE LONG-RUN POSTWAR SITUATION

## INCENTIVE PROBLEMS IN REGULATED CAPITALISM

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Analysis from the standpoint of incentives or motivation is an undertaking which is rather familiar to economists and to other students of social affairs. It falls within the sphere of dynamic economic theory, so far as the latter is concerned with anticipations or expectations; for many expectations may also be regarded as incentives. The great cataclysm of a world war furnishes special provocation to the discussion of such topics. New stringent social controls are invented; widespread capacity for patriotic devotion is revealed; and high hopes are aroused that many of the best features of wartime collectivism may be adapted to the postwar world, and also that many of the worst features of the old world are gone beyond recall, so that we are on the threshold of a new social order.

In the present paper I shall, perhaps, spread myself more thinly than is prudent over too many of these large and nebulous issues; yet I shall dismiss with mere mention some which would take me quite too far afield. After a few remarks on the general nature of the problems, I shall discuss some relevant attitudes and outlooks of co-operatives, of labor organizations, of capital and management.

### I. *Nature of the Problems*

Whatever may happen elsewhere in the world, I assume that the immediate American postwar outlook is for an economic order which may be designated as "regulated capitalism." By this phrase I mean that the government's role in economic life will expand slowly, rather than either contract or continue accelerating at the early New Deal tempo, and also that government will seek much more largely to control private enterprise than to displace it. Such control, to be sure, may involve considerable further development of yardstick experimental and cost-measuring productive operations by public authorities, analogous to those which have long been carried on by our state agricultural colleges, and also analogous to Henry Ford's long-standing policy of producing a fraction of his own needs of nearly every part of his car, in order to keep tab on costs and prices of the suppliers from whom he purchased the remainder of his requirements. Many other types of government enterprise, to be sure, will persist and arise. Conversion of government-owned finance corporations, defense plants and shipping facilities, Lend-

Lease and relief operations, for example, will take some time. Moreover it is quite likely that our government will assume some relatively new forms of proprietorship, such as participation in quasi-cartels for shipping, exploitation of foreign oil fields, or what not.

The activities of American consumers' co-operatives, too, seem unlikely to be much larger than yardstick scale in the first postwar decade or two. If co-operative enterprise should spread through a major part of our economy, then the economic order will have lost much of its capitalist character. Not that "the profit motive" would be literally wiped out in this sector, but co-operative organization offers much more modest hopes and possibilities of gain to investors and to managers than does thoroughgoing capitalist ownership and finance.

So far as the foregoing assumption proves correct, what are some of the main problems of economic incentives that we shall face? To a great extent they will be those discussed in J. A. Hobson's little volume entitled, *Incentives in the New Industrial Order*. Writing in 1922, and speaking primarily of British affairs, he remarked:

> The recent rapid growth of combinations on the part of Capital and Labour, the strength of the Co-operative Movement, the financial needs and demands of the State, the frequency and severity of industrial conflicts have led increasing numbers of people to realize the necessity for a radical reconstruction of industry. War experience has quickened this thought, as it has quickened the actual processes of change.
>
> The New Order emerging in this country is neither State socialism, syndicalism, voluntary co-operation nor guild socialism, but a blend of these and other schemes, varying with the conditions of the several industries. But it embodies certain common objects: (1) the abolition of unrestricted profiteering; (2) the substitution of representative government for employers' autocracy; (3) measures for apportioning the product equitably and by pacific agreement among the parties interested in industry.
>
> The workability of such reforms cannot, however, be taken for granted. The New Order is challenged by defenders of the old as impracticable, because capital will fail or fly abroad, inventions, enterprise, and initiative will collapse, discipline will be slack in the workshop, and government interference will impair efficiency. Hence productivity will be low, and we shall be unable to maintain our population on a satisfactory level of subsistence, much less continue a career of industrial progress. These troubles, it is alleged, must follow the failure of economic incentives under the New Order.[1]

It may seem to many of us, now, that the changes which became visible in British and American economic life after the first World War did not, by any means, add up to a New Industrial Order. But, whether we happen to think that that interwar epoch suffered from too many novelties or from too few, we can all easily recognize as prevailing now the fears as to failures of incentive to which Hobson referred two decades ago. Many of the same gropings toward a new order are visible today, if we make proper allowance for mere verbal changes, as the spirits of movements like syndicalism and guild socialism have transmigrated into younger bodies.

Among important aspects of my title which I am not prepared to

[1] *Op. cit.* (London: Leonard Parsons, Ltd., 1922), pp. 5, 6.

discuss at this time is one emphasized lately by Schumpeter.[2] I mean the friction generated by government regulation of business, and the large resources employed by both parties in this apparently wasteful process. Advocates of public ownership have long urged that it is socially much cheaper for government to manage industries directly, than to maintain public officials to manage the private managers. The Webbs' *Constitution of the Socialist Commonwealth of Great Britain*, however, gives strong arguments in favor of public authorities, under socialism, maintaining research and control agencies which seem quite analogous to our Interstate Commerce and public utility commissions. The quality of public regulation, moreover, should be improved by reduction of inequality among personal incomes, since one of our great problems has been the tendency of big business to hire away from government many of the latter's most competent servants.

## II. *Attitudes and Outlooks of Three Groups*

A. *Incentives Pertaining to Consumers.* It seems expedient to me, as it did to Hobson, to focus attention upon three types of interest which may be designated "consumers," "labor," and "business enterprise." The incentive aspects of government are not thereby entirely neglected, for we shall have occasion to notice some of the ways in which each of our three interests, as it utilizes political methods, thereby raises social problems of motivation.

Is the consumer's interest the general or public interest? Do consumer organizations tend to work for incentive arrangements which encourage abundance for all, rather than scarcities benefiting the few? Only somewhat qualified affirmative replies should be given to these queries. There are many co-operatives, of course, like milk-producing associations and other constituents of farm-bloc politics, which exemplify Professor Carver's proposition that co-operation does not so much tend to abolish competitive effort altogether, as enable the members of the co-operative more effectively to compete with outsiders. In a sense, every pressure group is a co-operative, and every co-operative is a pressure group.

Undoubtedly many types of business or institutional purchasers, such as railway shippers or industrial coal users, can be organized and can thereby check the powers of producers and sellers; but obviously the public interest is not necessarily or always served by monopsony any more than by monopoly. Employers, as organized buyers of labor, sometimes co-operate with trade unions (which are organized sellers of labor) in practices which are restrictive or otherwise antisocial.

Despite these and other limitations of the existing consumer and

[2] *Capitalism, Socialism, and Democracy*, pp. 197, 198.

buyer organizations, the consumer point of view is a great deal more than either a pious aspiration or a camouflage of certain pressure groups. As the Webbs pointed out, when a municipality or other public authority provides, at public expense, education or health service or what not, its citizens thereby become members of an obligatory association of consumers; and the practical limits of these, as well as of voluntary consumer associations (and of the productive enterprises which the latter can own through their wholesale associations) appear to be due for much further expansion. Producers' co-operatives share with consumers' co-operatives the trait of limiting opportunities for individuals and families to amass fortunes—although, like other associations, as they grow larger, they offer constantly richer prizes of power and patronage to their chief trustees and executives. In other words, co-operative and limited-dividend undertakings tend to curb the scope of capitalist motivation of the get-rich-out-of-profits type, so far as individuals and families are concerned. The co-operative association itself, however, may get rich by plowing in profits; in fact, co-operative enterprise has been financed very largely out of its own profits. Another resemblance is that co-operative principles preserve most of the democratic features of *quid pro quo* transactions, thus permitting minority votes by purchases in favor of particular commodities and services. The low share-price and the one-member-one-vote principle, however, render the conduct of a co-operative somewhat more like the operation of a political body than of a capitalist business.

As a final comment on the consumer angle of economic motivation in the coming years I should like to echo E. H. Carr's proposition that we need to develop a collective determination to sustain consumption of civilian goods during peace which shall more nearly match our determination to sustain consumption of munitions during war. Undoubtedly, from the economic standpoint, war is a form of social consumption; and so long as it lasts, unemployment and many restrictive practices are relatively amenable to control. As Carr says:

> The unemployment problem can be solved in time of war because war provides an aim deemed worthy of self-sacrifice. It cannot be solved in time of peace, only because modern civilization recognizes no peace-time aim for which people are prepared to sacrifice themselves in the same way.[3]

B. *Role of Organized Labor in Postwar Incentives*. From consideration of consumer organizations we may pass now to some brief reflections on producer organizations, beginning with labor unions. Let us disregard, for brevity, the many peculiarities to be found among associations of "workers by hand or brain," including the differing degrees and types of interest, among labor unions, in consumer affairs. Among

[3] *Conditions of Peace*, p. 104.

points of outstanding importance are these: (1) labor's dilemma of security and abundant production; and (2) its almost equally difficult dilemma of democratic equality and abundance. After some discussion of the approaches to these problems now manifested by the labor movement, we shall examine the prospects as to conflict and reconciliation from the side of business enterprise.

1. *Labor's Dilemma as to Security and Abundance.* This is but part of the familiar and much broader "clash of progress and security," to use Allan Fisher's significant title. There is a general tendency among all income-getting groups to throw up defenses, to develop vested-interest complexes in attempts to freeze existing quotas and methods of production, if not otherwise to restrict production.

Gradual readjustments are, indeed, made to changing conditions. Thus, the rise of industrial unionism and of craft federations has mitigated excessive apprenticeship limitations, dues, and jurisdictional warfare. But union officials are still forced, by the specters of unemployment and loss of popularity with the rank and file, to rely rather heavily on policies and practices which often involve vicious circles of freezing and rationing, narrowing total job opportunities, and resisting reductions of labor costs, if not raising them.

In the vast complex of union policies and practices which appear in private collective bargaining, considerable importance attaches to issues connected with wage incentives. Many of us can sympathize strongly with labor's distaste for all manner of fancy bonus schemes which have been foisted upon unorganized workers; and we know also that plain piecework, too, is subject to a great variety of abuses, especially in the absence of trade union power. But the present extent of organized-labor opposition seems more than can reasonably be accounted for by these justifiable grievances, and it may be plausibly argued that resistance to wage incentives is at bottom a make-work policy—a resistance to high rates of production which, from a short-run view, often threaten to aggravate the menace of unemployment, and sometimes actually do aggravate it. This argument (that union frigidity to piecework is motivated by the "lump of labor fallacy") gains much of its plausibility from the considerable aggregate of union rules and practices which are clearly of a make-work or "feather-bed" nature; also a good deal from the preponderance of evidence that incentive workers tend to earn 10 per cent to 25 per cent more per hour than day workers, by producing at least that much more—and nowadays, rather seldom at the cost of any demonstrable impairment of their health. It seems difficult, therefore, to reconcile the recent action of our largest union (United Auto Workers-C.I.O.), in prohibiting the introduction of wage incentives into day-working shops, with the concern which

nearly all its members certainly feel for maintaining high production of the instruments of warfare on which most of them are directly employed.

The foregoing analysis contains all too much truth, yet there are other truths too, which are needed to round out the picture. The automobile union voted the policy mentioned above by a rather narrow majority, despite the unpopularity of group-bonus schemes which helped this union into being a few years ago. The more general trend among labor unions has recently been toward increasing acceptance of piecework for the sake of speeding up war production. And even where piecework is strongly resisted, there tends to be less objection (if any) than formerly to the setting of production standards by time study and allied engineering methods. Determination and mutual acceptance of suitable checks and balances on wage payment methods naturally take years of trial and error, after an industry is first unionized. Here, I think, is a main reason for the difficulties which are now apparent in some of the newer C.I.O. unions.

After allowing for this normal seasoning effect, however, some very difficult problems of wage administration will continue to face unions, managements, and the public. The fundamental difficulty is to obtain a proper perspective. The unions, for example, have good reason for suspicion of some extra-fast workers, yet all are conscious of a fringe of superior people in every occupation; and only the most doctrinaire equalitarian radicals really want to deny superior people the opportunity to earn superior pay. A good piecework system automatically provides such opportunity; as does also a good day work system. In most shops piecework cannot be directly employed for more than about half the man-hours worked, by reason of lack of sufficient volume in some jobs, and lack of sufficient standardization in others. For day work, hourly wage rates that vary according to the individual worker's merit should be seriously considered by those progressive managements and unions which are properly concerned with continuous cost reductions and with giving customers more and more for their money—which is the only fundamental basis of long-term job security and prosperity.

Let us not, therefore, become too pessimistic merely on the basis of reports that some union groups are inhospitable to piecework. There are various ways of adequately adjusting the worker's pay to his productivity, and few unions are opposed to all such methods. The issues involved here, moreover, are relatively simple; the general run of workers are predisposed to favor arrangements which allow them to earn more by producing more, where such arrangements are well protected against arbitrary and careless administration, and against working themselves out of employment. The tendency, rather commonly found among unorganized as well as among unionized workers, toward

practices which tend to hold the work-pace down toward a mediocre or dead-level performance, is based more largely on common sense than management-minded people realize. The menaces of unemployment and underemployment are very inadequately appreciated by people who themselves have a high degree of security; and such people, furthermore, do not realize how much need has been felt, by average and weaker workers, to protect themselves against the strain of speed-up methods, nor how urgently do social-conformity motives impel the stronger workers to hold their work and earnings down to levels comfortably attainable by the weaker. In a moment we must inquire along what lines management may move to release some of these brakes.

2. *The Conflict between Democratic Equality and Abundance.* Is there actually a quest for equality in the labor movement? When workers demand "equal pay for equal work," they are not necessarily expressing an equalitarian philosophy, for literally this slogan merely calls for a standard pay rate for a standard unit of work. And I argued above that desire for a dead level of earnings by all workers, regardless of skill and effort, is abnormal rather than common in organized labor. Why, then, do I speak here of the quest for democratic equality? It is a matter of degree. In general, unionists approve of skilled workers earning up to twice as much as unskilled; but they tend to disfavor incomes which go very much over the skilled worker's, especially the larger incomes from property. It seems probable that organized labor's support of the New Deal, and vice versa, was much more than a marriage of convenience; that an important motivation of New Dealers both in and out of the labor movement was and is equalitarian sentiment. One specific indication is the C.I.O.'s insistence on an income-after-taxes ceiling of $25,000; another is labor's support of programs for raising floors under wages. (Of course, leveling up wage rates toward the higher ones already paid for apparently similar work elsewhere is part of the stock in trade of every union organizer; this sort of equalizing, always upward, by itself signifies but little as to fundamental equalitarian philosophy.)

The preceding paragraph indicates why I impute a quest for democratic equality to the labor movement. What may be said, now, as to its compatibility with the quests for security and abundance, i.e., of ever higher standards of living? The aims of security and equality are more readily reconcilable than the aims of equality and abundance. It is obvious, of course, that various equalizing programs can give more abundance, at least temporarily, to those who were in the lowest ranks before the equalizing began; but I do not believe very many top labor leaders really think that the interests of wage earners as a group would be much benefited by extreme equalization of incomes. For the moment, however, let us notice a few illustrations of relative harmony between

security and equality policies. When a degree of security against unemployment, for example, is sought by shortening hours, quite obviously all are treated alike; and even when layoffs are made according to seniority, the method is democratic in that it is a protection against favoritism. Increased social security for the masses who had, and still have, the least security has been one of the truly great accomplishments of the New Deal.

Economists are familiar with reasons why social security programs of this type are, to a large extent, in harmony with the aim of greater abundance for all. In some cases they may rob Peter to pay Paul, and in some forms may put a premium on withholding of effort. But by and large, through a comprehensive social security system we try not to get something for nothing but rather to purchase security on the installment plan. In the long run the system, by maintaining a floor under expendable incomes, seems well calculated to mitigate depressions and thus to keep the economic system producing on a higher average level than it would if depressions were allowed to cut deeper. In other words, equalitarian features of this type of program do not necessarily make it inimical to social productivity.

But enthusiasm for very rapid progress toward economic equality among men is apt to stand in the way of more rapid progress toward abundant means of livelihood for all men. Leveling upward the pay of the less skillful and industrious workers tends to impair their incentive toward acquiring skill and putting forth effort; but this proposition is sufficiently obvious to the ordinary worker so that the labor movement will not persist long in this error. The dangers of indiscriminate leveling downward of management and property incomes, however, are less obvious and require more careful study by all of us than is always feasible or congenial. There is danger that labor will be too predisposed to favor government and co-operative enterprise out of sheer hostility to large salaries and profits.

C. *Incentives of Capital and Management.* Our final theme may be approached by a few remarks on participation by labor in functions traditionally reserved to management and government officials. It is now commonplace that organized labor should exercise great powers through both collective bargaining and labor politics; but labor demands, voiced by Messrs. Murray and Reuther and others, for participation in industry councils are regarded in some managerial quarters as revolutionary syndicalism. This reaction has carried over to the joint committees for increasing production, which have been urged by the War Production Board. Very few advocates of labor representation in centers of policy making today, however, talk much about labor's right to run the whole show, even in the very distant future; they say, rather, that labor is so vitally affected that its spokesmen should be

consulted in advance; and also that such consultation will tap great resources of creative knowledge in the labor ranks.

What is the net import of this movement with respect to managerial incentives? Does it aspire to make two or three managers grow where but one grew before? It seems to me that this program of industrial democracy will develop the more constructively, the less management and labor leaders worry about how far or fast it will ultimately go, the more they concentrate attention on immediately practical steps. So far as top managements are obsessed by the idea that the labor leaders with whom they have to deal are playing revolutionary politics, obviously these managers are not in the best frame of mind for dealing with labor. And when labor overlooks the point of the parable of the talents—"Thou hast been faithful over a few things, now I will make thee ruler over many things"—and neglects to do the best job possible with the responsibilities it already has, its aspirations for much larger functions tend to handicap its present social usefulness.

Another point or theory of major importance, to my mind, is this: although labor representatives, in plant and industry and public councils, are in general well fitted to serve as a "loyal opposition" or critic of the managerial and administrative authorities, their fitness really to assume responsibility for major policies and administrative measures seems severely limited by the necessity of retaining continuous popularity with their membership in order to stay in office. Some of the same people who have most strongly urged the formation of industry-managing councils, for example, in which labor should be a colleague on equal terms with representatives of management and government, have recently opposed wage incentives more sweepingly than they probably would have done but for momentary expediency in their organization's politics.

Labor representation has already been tried to a greater extent than is generally realized; and the results are very encouraging to anyone whose hopes are not too high. The reactions of Soviet Russia away from excessive controls from below over military and industrial leaders, also the parts played by Soviet labor unions in increasing production, may or may not have much significance for Americans. The rather lengthy history of suggestion systems and union-management co-operative committees shows clearly that there is no very large number of ready-made technical or managerial geniuses in the rank and file of wage earners, yet that such encouragements of constructive thought may afford very potent incentives toward study by the workers of production problems. In addition to the union-management co-operation movement, the British Whitley Councils and Trade Boards, and our various labor advisory committees and members of government war boards, provide an extensive history of opportunities for labor leaders

systematically to contribute ideas and influence upon current major problems affecting their constituents. No doubt many instances might be cited where they have shown much more than "loyal opposition" capacities; yet I suggest we can save ourselves from needless disillusionment with labor's participation in policy making and administration if we remember that a labor leader's job tends to depend on his maintaining continuous popularity with his rank and file. This, no doubt, is a weakness of all ultrademocratic political structures; and it may well be that various middle grounds between extreme democracy and extreme boss-rule in union structure are most favorable to utilization of the talents of labor leaders for the broader interests of the membership.

The foregoing remarks on labor aspirations toward policy and administration were inspired in part by my belief that this movement tends to puzzle and discourage many persons of influence in industry and government, and that better understanding of it would provide better motivation of capital and management. And now we may consider some matters which bear more obviously upon the psychology of managerial and investing personnel. Let us designate "venture capital and management" as the main theme and attempt to throw a few sidelights on the dilemma between the investor's quest for security and his quest for increasingly abundant production.

This dilemma is perhaps most obviously manifest in the tendency to seek protection against competition. The disposition to press beyond the reasonable bounds of protection afforded by patents, trade marks, import duties, and laws against unfair competitive methods, to seek more and more tariff protection, cartel organization, and assistance from labor unions in hamstringing competitors, lies behind Moulton's title, "The Trouble with Capitalism is the Capitalists."[4] Such things of course have many social implications. One, which seems especially relevant to this paper, is that excessive protection against competition is among the discouragements of venture capital, as compared with more timid capital. Handicapping competitors may give the capital within the protective walls a temporary increase in security (and usually a higher return than is normally compatible with such high security); but this security for insiders is achieved by restricting the field for the venturing type of investment by outsiders. In a word, *free* enterprise is a requisite for the utmost of *progressive* enterprise, as contrasted with the more cautious and less creative investment in gilt-edged securities, which are commonly based upon somebody's pioneering or competition restraints of yesterday (or upon expected taxing power, in the case of government securities).

[4] *Fortune,* Nov., 1935.

Before leaving the subject of capital supply as such, I should like to mention even more briefly two other trends which seem likely to be increasingly important in the postwar period. These are philanthropic foundations and insurance of investments. The importance of the former was underlined recently by the announcement that the great bulk of the late Edsel Ford's fortune had passed, before his death, to the Ford Foundation, devoted to somewhat obscure philanthropic ends and doubtless ultimately, if not now, the owner of nonvoting securities accounting for most of the value of the Ford Motor interests. No doubt increasing taxes on estates and gifts have greatly accelerated this trend toward establishment of philanthropic funds. The Federal Trade Commission's report on national wealth and income, published nearly twenty years ago, devoted one chapter to the control of wealth by private nonprofit bodies;[5] and their position as owners must be considerably more important now. It is obvious they are not fitted to be venture capitalists; they swell the procession of people seeking senior securities.

Some increase in security of investment, more compatible with venturesome enterprises, appears possible by insurance methods. I am generalizing here, primarily, from the insurance features of the Federal Housing Administration; and generalizing with all the assurance of fragmentary knowledge. Various postwar planners are putting forward analogous ideas with reference to underwriting and encouragement of pioneering small businesses. Insurance for investors would seem inevitably to subject the firms using the capital to more bureaucratic requirements than was known in earlier days of capitalism, somewhat as FHA restricts a bit the liberty of the housebuilder who avails himself of its facilities to secure capital. But in relation to all the other tendencies toward large-scale and bureaucratic management, the controls incident to such insurance would appear to handicap the venturesome pioneer entrepreneur but little.

My final paragraphs will carry somewhat further the theme of venture versus playing-safe investment, but now in closer relation to inequality of incomes. My notion is that the spread between lowest and highest personal incomes after taxes should be considerably further reduced; but that the incentive effects of various taxes make it almost as needful to tax types of income differentially as total amounts of income received by the taxpayers. It is not clear, for example, that the American taxes on incomes of corporations rest very largely upon better principles than the ease of collecting from such companies. The corporate form of business is handicapped, perhaps more than is now rational; and the small stockholder with small total income is afforded less incentive for venturesome investment than if the total income tax

[5] 69th Cong., 1st Sess., Sen. Doc. 126, Ch. 8 (1926).

load were more largely based upon personal incomes and less upon corporate incomes.

And now let us focus attention for a moment on the individual receiving a high income, inquiring along what lines he may be taxed so as to minimize adverse effects upon production. It may well be true that still more steeply progressive rates of income tax will not too greatly impair his will to save; but such tax progression surely does tend to make gilt-edged investments relatively more attractive to him, by comparison with venturesome investments. I am not saying that net-income-after taxes is necessarily the most potent incentive toward pioneering investment; but whatever strength it has is largely emasculated if most of the profits (if any) are predestined for the tax gatherer. In sharply progressive taxes on incomes, therefore, we see another member of the team of forces tending to divert investment from venturesome enterprise into government and other play-safe securities, whether the latter are tax exempt or not. To some extent, as intimated above, this problem may be tackled through taxation methods which bear relatively more heavily upon gilt-edged incomes than upon those derived from legitimate venturesome undertakings. Such encouragement of venture seems most feasible within moderate brackets of personal incomes, for people are likely to insist upon very steep tax rates on the highest income brackets for the sake of curbing concentration of economic power. The largest fortunes, therefore, seem destined for the safer and lower-yielding investments—supposing that such investments continue to be available. Conceivably legislative and voluntary practices might develop which would make a larger and larger share of all property incomes the equity, or common-stock type. Such a trend would tend somewhat to reconcile the conflict between equality and progress, with reference to the highest incomes.

If time permitted, we might derive a good deal of instruction from John A. Hobson on his favorite theme that higher and more secure incomes for the masses of people, better public control of investment practices, and collective saving by public and co-operative authorities tend to stimulate increased savings among the low to middling income groups to such an extent that our economy has a lessening need of capital supplied by the rich. I am rather less sanguine than was Hobson as to the nature and extent of social benefits which may result from personal-income-leveling trends. The prospects sketched above in this paper, however, like Hobson's later writings, point to the persistence and progress of a mixed economy, in which organizations of labor, co-operatives, and public authorities will take an increasingly prominent part, but in which the bulk of production continues to be supplied by private profit-seeking enterprise.

## DISCUSSION

R. A. GORDON: While I should prefer to confine my comments entirely to Professor Dickinson's paper, I find this rather difficult to do. His paper is not so much an integrated essay as a series of casual reflections, not too closely tied together, a good many of which are not pursued far enough for me to decide whether I agree or disagree. Hence, while commenting upon Professor Dickinson's conception and handling of his problem, I shall also take the opportunity to wander down a favorite path of mine, which Professor Dickinson ignores but which is extremely relevant to the topic under discussion.

I am not really sure what Professor Dickinson's primary theme is. Neither his title nor the paper as a whole answers my questions on this point. What does he mean by "incentive problems"? He begins by referring to "incentives or motivation." These are not synonyms. Is he concerned with motives or with the incentives which a system of "regulated capitalism" offers to satisfy these motives? The paper shifts from motives to incentives to general group objectives. In view of the lack of systematic consideration of incentives, Professor Dickinson's title might better read, "Some Economic Problems in Regulated Capitalism," although I am not sure that his problems are the ones most worthy of discussion, either from the point of view of incentives or in a more general context.

The author also fails to do justice to the second part of his title. His definition of "regulated capitalism" is one of a system in which government "controls" private enterprise instead of "displacing" it. He does not touch upon the real crux of the issue: What forms does the control take, and how do these types of control impinge upon the system of incentives to which the various groups in the economy react? This subject alone is worthy of an entire paper bearing the title under discussion.

I wonder why Professor Dickinson devotes the space that he does to the consumer movement. (I say "the consumer movement," although Professor Dickinson seems to discuss the consumer movement in general, consumers' co-operatives in particular, and co-operatives of all kinds, including producers', more or less in the same breath.) I agree with the author that consumers' co-operatives are not likely to be very important in the first postwar decade or two. If so, it is difficult to explain the attention he pays to them when topics more fundamental to the problem go practically unmentioned.

Professor Dickinson poses two dilemmas with respect to labor incentives: security versus abundance, and abundance versus equality. (Are these incentives or group objectives?) In discussing the first of these dilemmas, he gets directly to the question of financial incentives. Labor's desire for security leads it to oppose wage systems geared to productivity, which are necessary for high output and abundance. He is optimistic that this conflict can be resolved with time and careful handling. I agree, and Professor Dickinson would probably agree with me that responsibility for a sensible solution rests as much on management as upon labor.

I do not altogether follow his discussion of the dilemma of equality versus abundance, nor do I fully see the relevance of this discussion to the question

of incentives. I agree that labor's desire for security, as expressed in a comprehensive program of social insurance, is compatible with equalitarian tendencies, since it lightens the lot of the unfortunate. Beyond this, the discussion of equality in the labor movement does not seem to go much further than to warn labor that indiscriminate leveling of management and property incomes is inimical to a high level of output in a private enterprise system. I wish Professor Dickinson had discussed, in terms of incentives, to what extent this is true and under what conditions it might be only in part true.

Professor Dickinson labels his last section, "Incentive to Capital and Management." He has something to say about capital incentives, including some remarks on taxation and on the possibility of offering government insurance to risk-taking investors, but he has almost nothing to say about management incentives. He does refer to management's antagonism to labor's participation in management. On this he takes a conservative and well-reasoned view. Labor is not trying to take over management's job. Further, labor would do well to put its own house in order and to be prepared to meet its responsibilities before pressing for a larger share in top-management councils.

The last section of the paper badly confuses the separate functions of capital investment and active business leadership. The desire to seek protection from competition is attributed to the investor. Avoidance of competition may affect capital supply and the returns to risk-taking capital, but the motives and incentives involved apply much more to management, especially in large-scale industry, than to capital. This leads me to the path which Professor Dickinson failed to explore but which is critical to any discussion of incentives in a system of regulated and "trustified" capitalism.

What role will profits play in a system of regulated capitalism dominated by the large corporation? Profits *for the firm* will continue to perform their allocating function, guiding the direction of production and providing the fundamental criterion for business decision-making. But what role will profits play as a personal incentive, in the form of income to some productive factor? In the large corporation, the stockholder has largely become a passive capital supplier, and the active business leader is not ordinarily a large stockholder. What would happen if we commuted profits in established large corporations into fixed income payments, diverting profits above such payments, if not to the government, into mandatory reserves for expansion, management and employee benefits, or for some other purpose? Profits as income would then be left as an incentive only to the business leaders of small enterprises and to investors in new undertakings. I suspect that such a scheme would be more compatible with efficient operation of an economic system dominated by large and bureaucratic firms than the system of distributing profits which now prevails.

Profits are rapidly ceasing to be an incentive to top management in large corporations. Large-scale business leaders, who for the most part are to be found within corporation management and not among the stockholders, bankers, or other nonmanagement groups, react primarily in response to the incentives of a large relatively fixed income, security of tenure, opportunities for power and prestige, and satisfaction of the creative urge. Except for a dif-

ference of degree, particularly in the matter of the size of money income, these are the same incentives that attract individuals to public service. In brief, the large corporation is drastically altering the function of the "profit motive" in the economic system; that is, profits are ceasing to be the primary spur to active business leadership. We should learn how to utilize the array of non-profit incentives to which large-scale business leadership reacts in order to secure the kind of business leadership we want and to direct it toward the ends which we consider most desirable.

# POSTWAR LABOR PROBLEMS

## UNION POLICIES AND LEADERSHIP IN POSTWAR AMERICA

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There are not many persons who would take exception to the statement that one of the important determinants of the kind of economic-political society we have in the United States after the war will be the attitudes of and the policies adopted by the leaders of American organized labor. It is of course a realization of this importance that has brought us here to discuss the matter. The reasons for assigning such significance to this topic are in the forefront of every economist's mind: We have lived through a decade of economic illness, a decade of underemployment of human, natural, and technological resources, a period during which the investment schedule moved uncertainly and haltingly back and forth across the chart of business activity. This was the period in which, to change the figure of speech and to use the words of Frank D. Graham in his exciting book, *Social Goals and Economic Institutions*, the American system exhibited "a malarial economic condition with alternate fevers and chills and more or less persistent lassitude." More recently, thanks to Hitler, who, I believe, was able to come into power chiefly because the economic system of his own country had for so long been afflicted with the same sort of persistent lassitude, and thanks to our reaction to Hitler, we have witnessed a tremendous resurgence of economic activity, with employment and income at unprecedented heights. And we are asking ourselves, after the war will business relapse into lassitude or will conditions be favorable enough for investment, income, and employment to continue at high levels?

This is where organized labor and its friends come in. The same prewar decade and the same war years have seen a great shift in economic and political power. Many laws have been passed to improve the economic status of the underprivileged and to protect them from the insecurities of modern economic life. Under government encouragement the American labor movement has at least trebled its numerical strength, with perhaps geometric accretions of economic and political power. Whatever the reasons may be, these developments have been one of the great changes of our time and must be reckoned with most seriously. And so the big question related to the question posed above is, will organized labor's leaders and friends use their newly acquired power to help develop conditions favorable to business enterprise and economic prosperity or will they use this power in ways which will discourage investment and result in underemployment of resources?

This question is perhaps only a part of other questions that are even more fundamental. We should all like to know whether organized business enterprise can adjust its attitudes and actions to the shift in power. Can enterprise be at all venturesome when it has to share power and when it has to live under laws designed to effect a more equal distribution of wealth and income and provide greater social security, as presently defined? What is the best kind of social security: protection for loss of economic status or freedom to pursue individual economic betterment? Is the first or official kind of social security compatible with the second?

As the one who begins this discussion, which I have been asked to confine to union rather than to business policies, I approach the task of answering some of these questions with a bit of trepidation and with a certain amount of humility. My trepidation arises from my belief that my remarks will almost surely be misinterpreted and even misused, both by those who are basically unfriendly to unionism and by those who are unreservedly in love with unionism (the former because they seize on "any stick" and the latter because they have not yet managed fully to discount their keen and immediate sensitivity on behalf of the underprivileged). I mention this because I feel it necessary, in discussing this topic, to make it quite clear that my own attitude is one of seeking the long-run welfare of labor.

My humility, which I assure you is not mock, comes not only from a recognition of our common inability to predict accurately future events and movements but also from a frank realization that it is undoubtedly a delicate thing for an academician—a person who is neither a unionist nor an entrepreneur—to find fault with and offer suggestions for the actions and attitudes of "practical men who must face hard facts, day after day."

## I

It seems desirable at the outset to list some definitions, assumptions, and limitations which will guide the discussion. I assume, first, a postwar world, after the reconversion period, in which the decisions of business enterprise to produce and to invest or expand output depend mainly on American peacetime conditions (which include, of course, labor attitudes and policies). We shall not be talking about the period after we beat the Germans but before we beat the Japanese or about the period of almost complete reconversion immediately after the Japanese have been beaten. Rather will consideration be given to the later period of what we hope will be normally consolidated international peace. Furthermore I shall not try to guess precisely what kind of peacetime world will be objective to organized labor. I do not know whether to posit the early or later post-World-War-I model of the

twenties or to have business stagnate secularly as in the thirties. The later or Japanese part of our war effort might enable us to taper or slide off from full war production into peace production with relative ease. Or the delights of new products and production techniques and the mental jolts of war experiences might cause entrepreneurs to shake off attitudes which used to cloud expectations and inhibit action. Or, if the technological frontier were not enough, there might be a geographical one such as China and other relatively undeveloped countries. Under these conditions enterprise might be somewhat less sensitive to union attitudes and policies than it has been in the past. But, as already stated, I prefer to assume a fairly familiar postwar world. One reason for this decision is that I wish to devote this paper chiefly, not to a discussion of the ways in which union policies may be shaped by the postwar environment, but to a consideration of the ways in which the postwar environment may be shaped by union policies. In other words, this paper will not try mainly to prophesy or predict but to suggest for labor a positive program possible of attainment.

Second, it is assumed that American democracy in its economic-political aspects will be essentially unchanged and that it will not be desirable to change it. Third, it is assumed that free business enterprise is the only system compatible with the principles of American democracy and that, inasmuch as the material well-being of the great majority of American citizens depends on the prosperity of business enterprise, conditions should be made favorable for its health, vigor, and education. It is assumed, fourth, that industrial or labor democracy, through free unionism and collective bargaining, is also an essential and desirable part of the pattern of American democracy, because business enterprise is not in a position to protect certain primary interests of American employees as adequately as are free labor organizations. Underlying the preceding two assumptions is the further premise that under conditions of modern technology the atomization of economic life is an economic dream impossible of fulfillment[1] and that therefore both the large corporations and associations of corporations and the large unions and federations of unions are necessarily here to stay. In other words, both corporations and unions are forms of collectivism, and some form of collectivism is necessary under modern conditions, either directly through the government of the state or indirectly through self-organized groups to which the state, by encouraging their creation and development, in effect delegates certain functions of government. Furthermore, to the extent that conflicts of interests are involved, it is desirable that collectivist groups which receive delegations of authority be approxi-

[1] Even agriculture, sometimes the atomizer's delight, is actually far from being atomistic, either economically or politically, especially politically.

mately equal in strength and authority. It seems also to be true that any group which, through state encouragement and protection, receives a delegation of authority must be prepared to accept responsibility for its actions and be prepared to accept a certain amount of regulation from the state. Because human groups and human institutions reflect human frailties, one of which is occasional failure to accept responsibility along with power, it is essential for society to have redress against the "chiseler" within any group. Most of the time the group itself can deal with chiseling; this is as it should be, because self-discipline is superior to externally imposed discipline. But the state as sovereign must retain ultimate control.

It is assumed that unionism will be really accepted as an integral part of the American social structure when it has demonstrated its capacity to make positive contributions to the welfare of most of the citizens. I do not believe that unions are now viewed with delight or even equanimity by farm owners, by small businessmen, or even by big businessmen. They are not unmentionable or untouchable, as they were in most quarters two decades ago, but they are still considered not quite "nice" by the so-called "middle class." Nevertheless, no one can deny that substantial headway has been made in the conversion of business attitudes toward unions; acquaintance has bred friendship and respect in many places. I should say that the matter of union acceptability hangs in the balance and depends enormously on future union actions, both during and after the war.

England and Sweden have taught us how strong employer and labor organizations can get along together, while other European countries have shown us the dangers of taking such co-operation for granted. It is assumed further, therefore, that co-operation of unions and employers in the common long-run interest is not only possible but also absolutely essential if American democracy is to survive and flourish. Organized labor's welfare is inseparable from the welfare of society as a whole.

Finally, on the more purely economic side, the following assumptions are made:[2] (1) In most American economic sectors, the marginal efficiency of capital and the investment function tend to shift unfavorably in response to wage rate increases and positively in response to wage rate decreases. It is not held, of course, that MV remains independent of changes in money wage rates or that opposing forces are not often operative with respect to such things as cost-price relationships, liquidity-preference schedules, and savings schedules, especially during certain phases of the business cycle. On balance, however, it is believed that changes in the level of wage rates produce the above-suggested

[2] It is recognized, of course, that most of these economic points are highly controversial within the profession. There is no space here for outlining the reasoning behind these "conclusion-assumptions."

effects on output and employment rather than merely changes in the level of prices. (2) Along with flexibility in the prices of goods and services, flexibility in wage rates is required (a) to facilitate shifts of output and employment from plants and industries where contraction is occurring or is needed to those where expansion is occurring or is needed; (b) to facilitate adaptation to international economic conditions; and (c) to help attain the output and employment consonant with American resources. (3) Government fiscal and monetary policy, inextricably related as it is to the general level of economic activity, can and should be used to encourage rather than discourage business enterprise by emphasizing taxation on personal incomes more than on business profits as such; and using well-timed and planned government expenditures, on such items as public works and low-cost housing, to activate rather than to compete with private investment.

## II

If these assumptions are tenable, it follows that organized labor in America can reasonably be asked and expected to conform to certain standards of social behavior. At this point, therefore, I should like to offer a few criteria for judging the social validity of a mature labor movement.

With respect to relations with employers, unions may fairly be asked such questions as these: Has evidence been given of a thoroughgoing recognition of large areas of mutual interest? Have co-operative attitudes and policies reached ascendance over those of conflict? Has a long-range point of view been adopted? Has responsibility been accepted in such matters as observance of contract, plant discipline, continuity of operations, and increased output at lower unit labor costs? Have intra-union and interunion conflicts been kept away from the employers' places of business?

With respect to relations with employees, these questions appear to be relevant: As far as nonmembers or potential members are concerned, how is unionism sold—coercively or peacefully and constructively? Is membership easily obtainable or is it seriously restricted by one or more of the well-known devices? Are union policies devoted to obtaining benefits exclusively for members, or is there concern for the welfare of potential members? As far as members are concerned, do union efforts relate solely to the winning of economic advantages, or is there substantial concern also for such non-job matters as housing and sanitation, education and cultural benefits, and recreation facilities? Is there real democracy in the government of the union, or do national or local officials disregard the rights and views of minorities (or even of majorities)? Is the leadership essentially honest or corrupt?

With respect to relations with the community and the nation, there are additional important standards. In general, have unions, as a collective instrument to which the state has in effect delegated certain important functions and authorities of government, displayed that degree of responsibility which is essential to all well-administered societal arrangements? In terms of their relations with employers and employees, have they governed themselves and their shares in industrial and community life wisely and constructively? Have they planned in terms of the common good? Specifically, have unions made substantial and significant contributions to increasing the national income? Have they operated to help insure the full employment of economic resources as vigorously as they have tried to obtain a wider distribution of the output of resources however employed? Have they compared the sizes of their members' annual incomes, which presumably have reflected at least a partial success in their drive for less inequitable income distribution, with the sizes of these incomes which might have been achieved if labor's emphasis had been partially shifted to technological advance and full employment? Have they given real consideration to themselves and other citizens as consumers? Have union policies and leadership made for basic social peace or for turmoil?

## III

The standards represented or implied by the above questions do not seem to me to be excessively high, much less Utopian, even for the American milieu. It is true, of course, that thus far, even in wartime when the common peril dictates the need for acceptance of sacrifice and hardship, labor's performance has been a little uneven and its record somewhat spotty. But the very fact that some unions have met almost all these standards indicates that most unions could do so.

In peacetime, at least, any failure of organized labor to achieve social standards was condoned by many of us because we believed that the movement as a whole had not yet reached maturity. It was, we felt, still youthful or adolescent (if I may employ these terms without invidious intent). Some parts of the union body were relatively mature: they had grown faster (like the legs of young men) than other parts. Thus, we all had our lists of "good" unions, "mediocre" unions, and "bad" unions. A good union was one which had a record of (1) co-operating with employers in a statesman-like manner with respect to wage-cost-price relations, plant discipline, observance of contractual obligations, and so forth; (2) carrying on effectively a large number of welfare activities, such as workers' education, sickness benefits, and summer camps; (3) having no truck with racketeering or graft; (4) providing a substantial measure of intra-union democracy; and (5) participating in community and national affairs in a social-minded way. A bad union was one which

had an opposite sort of record, and a mediocre union was usually "respectable" but dull and unimaginatively "business" in its policies.

Now we all said that in due time—as the newer unions consolidated their membership gains, their financial accretions, and their employer recognitions—their attitudes would change from combative to conciliatory and from underdoggedly sensitive to confidently mature; the pugnacious, organizing kind of leader would be replaced by the negotiating sort; and the policies of unions would reflect a much broader understanding of the place of organized labor in the scheme of things.

I still think our prewar views on this matter were in general correct. But I for one probably failed to consider seriously enough the need for speed in accomplishing these adjustments. From the vantage point of 1944, as one reviews the forces which made the war and as one observes certain home-front labor events of the war, the time seems very much shorter than it used to seem. I am not at all certain that there can be a forced growth to maturity, but I am completely convinced that the need for such growth is extremely urgent. The conjuncture of social forces all over the world has far from worked itself out. Capitalistic democracy has still to prove its survival value in the twentieth century environment. It may not survive even with union maturity, but in my judgment union maturity is an essential of survival. Those of us who believe that modern society requires a strong, responsible labor movement do not wish to see a repetition of post-World-War-I events. We fear that businessmen, nonunionists, and soldiers will be so alienated by the lawless acts of a small minority of irresponsible, powerful union leaders that the labor movement, far from attaining maturity, may be stunted by external anti-union forces or may undergo a schizophrenic retrogression and even die.

## IV

Faced with this possibility and on the basis of the assumptions and criteria already enumerated, can the American labor movement plan and execute a positive program that will inspire confidence among employers and the public and will contribute significantly to the national welfare and prosperity? I think that it can, and I venture here to suggest the outlines of such a program.

It goes almost without saying, of course, that any suggested policies must be solidly founded on hard realities and must not disregard the limitations of American human nature. But it must also be remembered that one of the hardest of the many realities is the imperative need for inclusive acceptance of unionism. And we, who have for years been preaching enlightened selfishness to employers, would surely seem to be justified in asking as much from organized labor.

The program outlined here has two main aspects: economic and po-

litical. Among the economic policies that might feasibly be adopted are the precise definition and delimitation of the areas of control to which unions aspire in plant operation, job tenure, plant discipline, and so forth; the official and actual abandonment of practices which restrict output; the development of union-management-co-operation plans to increase output and reduce unit costs; the devising of flexible wage policies for various kinds of specific and general business and economic conditions, with emphasis on creating and maintaining job opportunities for all workers; the development of output and price policies in broad terms (including recognition of price reductions as a major alternative way of widening the distribution of income); and, in connection with all these things, the enlargement of the area of collective bargaining from the individual establishment to entire industries, with the ultimate objective of working out general decisions through national collective bargaining between a national federation of employers and a national federation of unions.

Most of these suggested economic policies, in the general term in which they have just been stated, could probably be assented to without too much difficulty by most of the country's top-flight labor leaders, in much the same manner that almost anybody could honestly give affirmative answers to such general questions as, do you believe in wage stabilization? or do you object to sin? But the economist who asks such a question on wage stabilization should be compelled to define for us what he means by stabilization (i.e., whether he means a real wage "freeze" or a tough but flexible wage-control policy or a mere deceleration of wage rate increases, and so on), and the Baptist preacher should have to tell us precisely what he means by sin. Only then do both question and answer have any real meaning. In the same way, it is necessary that the suggested economic policies be discussed here, within the limits of available time, in fairly exact terms.

It is a commonplace that the successful operation of any enterprise or organization (whether a business partnership or a government or an army) involving the co-operation and joint efforts of two or more persons depends partly on a clear definition and demarcation of the responsibilities and authorities of the respective participants. Without such definition, truly effective operations are impossible, and administrative chaos often develops. It follows that the unions should give serious and immediate thought to, and business enterprise is justified in asking to know, just what organized labor, as the collective bargaining partner, considers its functions and its powers and duties to be with respect to the operation of any business enterprise. Uncertainty about such matters obstructs business planning and helps to curb business confidence. Certainty, even certainty about unfavorable events to come, is more to be desired than uncertainty. Management, under collective

bargaining relations with unions, has relinquished many of its former prerogatives. It suspects that it will have to yield still others. Although agreeing to do so came hard in many instances, net social benefit probably resulted. But, so long as a partnership remains, there must be limits to the prerogatives of each partner and limits to what any partner can accept in any shift of prerogatives between partners.

It may be objected at this point that, because business enterprise has always operated under many kinds of uncertainties (as a matter of fact, this is a main characteristic of free enterprise) and because unions cannot afford to state ultimate objectives in any but the vaguest terms (nor indeed can they, under dynamic conditions, foresee what their objectives and tactics will be), such a proposal is utterly unrealistic and impractical. In themselves, as statements of fact, these objections have force. But they do not constitute a valid basis for rejecting the proposal, because the proposal does not mean to suggest anything so naive as that organized labor should come forward and reveal a detailed blueprint of all its goals and policies and demands for each enterprise and industry and for the country as a whole during the next, say, five or ten years. What the proposal does suggest is that organized labor should inform employers convincingly to what extent it wishes to participate in plant and industry management and government within limits imposed by the major different foreseeable patterns of business conditions. Thus, labor should be able to give employers a pretty definite idea of how it would like to participate under conditions of relatively full employment; this would probably indicate the minimum extent of participation. Labor also should be able to indicate rather definitely the maximum or upper limit of participation, which would probably be demanded under conditions of business stagnation and great unemployment, after industry itself had seemed powerless to provide full employment. Between these minimum and maximum degrees of participation there would be ample room for collective bargaining and for flexible adaptation to immediate and particular conditions.

In setting forth these lower and upper limits of participation, labor should be specific. It should state whether and how much it wishes to share in the selection and design of the goods and services to be produced; in the location of enterprises; in the layout of machinery and equipment and in the standardization of production methods and techniques; in the purchasing of raw materials; in the scheduling and routing of production; in the determination of price policy; in sales promotion and advertising; in the determination of wage rates and methods of wage payment; in the determination of working conditions; and in the hiring, training, promotion, transfer, discharge, layoff, and discipline of personnel.

The outlining of these things would not by itself inspire confidence. Whatever the limits were, management might consider them too high. Furthermore, any bargaining with respect to the limits themselves or within any accepted limits might be conducted in attitudes or moods of conflict. But the outlining of labor's views on such items as those listed above seem to be a needed first step in inducing attitudes and practices of co-operation. The next step is the actual abandonment of obstructive and restrictive practices by all of labor's unions and the actual adoption, by all unions, of co-operative attitudes and practices. There is no space here for discussing the details of or experiences under union-management co-operation plans. In the past, such plans in certain plants have embraced and in the future almost all plans may well embrace most of the items listed above. What needs emphasis here is that, whatever the area within which co-operation is supposed to function, it has worked very successfully in the past for certain unions (such as the Railway Shop Crafts, the Clothing Workers, the Steel Workers, the Hosiery Workers, and the Textile Workers), mostly in specific, relatively narrow, individual plant situations and that it now should be expanded to cover entire industries and, ultimately, most of, if not the entire, economic universe.

Before the war most of the union-management co-operation plans, so far as the unions were concerned, had to do mainly with saving and creating employment opportunities for union members in individual business enterprises where the employers had been threatened with insolvency under severely competitive conditions. The war itself has provided a considerable stimulus to union-management co-operation, the War Production Board and the War Manpower Commission having fostered numerous plans which operated with substantial success. The motivations in these cases differed of course from those of the prewar years: during the war the aim was to facilitate plant conversion and increase output under conditions of assured demand. But whatever were the prewar and war stimuli, there is no reason why, after the war, when industry will be anxious to proceed with peacetime adaptations of war-born products and methods, practically all unions should not be eager to contribute much broader plans of providing jobs for everyone and of obtaining more output at lower costs and prices, so that the "American" standard of living may perhaps at last be realized by everyone.

Co-operation on such a scale would appear to involve the creation of industry-wide and interindustry-wide bargaining and planning organizations which would be concerned with general questions of production policy, wage policy, price policy, and relations with the government.

The last item is of major importance for several compelling reasons. In the first place, the attitudes and actions of government officials, to-

gether with the laws they administer, are increasingly important in buoying or dampening business confidence. National collective bargaining would inevitably become interested in developing recommendations on taxation policy, government spending, and international economic relations. (On such matters, labor's aim should be to achieve a high degree of social benefit without unfairly burdening enterprise.)

Second, experience with the planning and with the policies of cartels and similar organizations provides no assurance that, even with organized labor's participation, the public interest would be seriously considered and preserved. It is doubtful, in other words, that without government participation and regulation the maximization of output and employment, with wide distribution of output through progressively lowered costs and prices, would continuously be a first objective. This does not mean that a government bureaucracy has to do the whole job of planning and execution or even the major part thereof; most of it can and should be done democratically through the employer-union organizations. Nor does it follow that government participation would inevitably be in the broad public interest; for example, the Bituminous Coal Conservation Act of 1937 was hardly conceived or administered mainly for the public. But the chances that the public interest will be protected are greater under tripartite than under bipartisan control. And the government, being superior in authority to any other groups to which it has delegated certain measures of authority, should retain the last word.

There are those who ardently wish the trend in government control of business affairs to be reversed. My own view is that, however desirable for various reasons it might be for government to be hustled off the stage of economic affairs, such a thing is impossible. Modern technology, through all its direct and indirect effects, has made it impossible. The problem is not one of getting government off the stage but of getting it to play the proper role—a role limited strictly to the economic necessities. I would certainly agree wholeheartedly with any one who hoped that government would not always station itself before the footlights and mug constantly to the galleries.

In short, we do not like the Hitlerian sort of government control over economic life, the Hitlerian method of dealing with the problems of the complicated economic mechanism created by technological change. But we should be excessively stupid to ignore the forces which put Hitler into power. Our problem is to recognize and to channel these forces by democratic methods into a socially healthy and fruitful kind of control, and to me this means industrial self-government plus benevolent political government.

There is yet another reason for government participation in and regulation of collectively bargained, self-determined broad economic

policy. There may be one or a few well-entrenched labor leaders who, because they are unusually self-centered and ambitious and because they believe they can further their own interests better by appealing to the rank and file of labor on the basis of conflict or anti-employerism than by preaching the doctrines of union-management co-operation, will make it practically (i.e., politically) impossible for the other, more constructive labor leaders to sell or practice co-operation. Inasmuch as the union memberships appear unable to rid themselves of domination by such officials, it follows that the antisocial acts of such a lawless, minority person or persons should be curbed by government legislation and administration such as that outlined below.

## V

The political program suggested here has to do with matters that are not so directly economic as those discussed above. It has nothing to do with political parties (including a possible labor political party) as such. It involves mainly a consideration of organized labor's internal affairs and policies and the relation of government thereto.

With respect to union organization and government and the administration of unions' internal policies in the past, several things are noteworthy. From the legal point of view, unions, being voluntary associations, were relatively free to rule themselves without government interference. Being part of a minority movement not generally accepted by business and the public, unions jealously defended this comparative immunity, for they rightly believed that any government regulation could, in the hands of government officials dominated by antiunionists, have been used to make them impotent, and they had had a hard enough time winning the right to exist and operate at all. But times have changed. Under the "New Deal" and "Win the War" governments, unions have grown enormously and have come close to winning social acceptance. And over a period of several decades union power has come, as it has in almost all human organizations in response to technological changes, to be highly centralized in the hands of the national officers.

All these things are well known. So also are the abuses which have developed during the struggle for status and power and after the achievement of power and the centralization of power. Our chief interest here is not in explaining or excusing these abuses but in suggesting how they may be minimized so that organized labor may obtain full social acceptance and actively fulfill its democratic promise.

The chief government instruments which encouraged labor's coming to power were the National Labor Relations Act and the National Labor Relations Board. The Act was and is, with respect to employers' dealings with employees and their unions, a charter of industrial freedom for employees and is based on a bill of industrial rights. Many

thoughtful friends of organized labor have come in recent months to believe that the time has now come to create a bill of rights for union members in their relations with their officers and leaders and perhaps also a bill of rights for employers in their dealings with unions and possibly to embody these bills of rights in appropriate legislation.

No one, I am sure, could object to the drafting of such bills of rights. The question that gives one pause is whether they should be embodied in legislation. Would it not be better to encourage labor to apply these bills of rights within its own structure and government? Is not self-discipline superior to externally imposed discipline?

I think I have already, in listing my assumptions, indicated my own answers to these questions. Most of the improvement in unions' internal behavior and in their relations with employers must come from within, initiated by top leaders of vision and statesmanship and carried out by aides who have caught the spirit of the statesmen. But because time is short, because the A. F. of L. and the C. I. O. lack explicit authority over the activities of member unions, and because, as in business, the chiseler and the irresponsible leader can make it almost impossible for men of good will to pursue socially desirable objectives, there appears to be a need for moderate, constructive federal and state legislation. And the principle of self-discipline can be honored even here, because organized labor might well develop and sponsor its own legislative program, embodying the practices of its own best unions.

It is not my purpose here to suggest specific organizational and functional alterations for the mansions of labor or to present a draft of specific legislative and administrative arrangements. These are matters for much future deliberation and discussion. The outline of necessary changes becomes pretty clear, however, when one considers what the better unions and leaders have themselves accomplished or proposed. What the majority of this country's citizens, union or otherwise, would like to see, I believe, is peace between the A. F. of L. and the C. I. O.—a resolution of their organizational and operational antagonisms, so that employers and the public will suffer no longer from this sort of destructive competition; membership in unions open to all employees, regardless of their color, sex, national origin, political affiliation, or financial status; the making of job opportunities controlled by unions democratically available to all members; participation in all union affairs open to all members, so that democracy may be available where it means the most to employees; democratization of union constitutions and bylaws, particularly with respect to the nomination and election of officers, decisions on special issues (including the levying of special assessments and the appropriation of funds for special purposes such as contributions to political parties), the right of expressing minority

views within the union, and the availability of detailed accounting of all income and expenditures; opportunity for appeal from arbitrary disciplinary actions by union executive bodies; a serious and determined effort to drive racketeers out of the woodwork of labor's house; a great increase in the quantity and quality of workers' education; abstention from violent, mass picketing in labor disputes; abstention from use of imported, nonemployee pickets; abstention from picketing an employer when union membership is a minority of employees, particularly after a labor board election has established the fact of minority; abstention from strikes arising out of jurisdictional disputes; a willingness, such as that shown by the railway unions for many years, to utilize, before striking, all peaceful means of dispute settlement, including acceptance of the mediatory efforts of government agencies during a moderate cooling-off period of, say, fifteen days and including, in certain basic industries such as coal and steel, the submission of unmediated issues, not to a board of compulsory arbitration, but to special boards of investigation and publicity appointed by the President or by his designee; a willingness to support certain sanctions against those who engage in certain unfair union practices; and active, public-spirited participation in community projects which require the support of various kinds of organizations.

## VI

It is at once evident that, so far as getting the spirit and letter of this program into operation in all the local unions of the country is concerned, I have suggested a fairly long-range proposal. As already stated, the fact that time is short is one of the reasons for believing that labor might well sponsor legislation for putting certain parts of the program into more immediate effect, with administration in the hands of existing government agencies such as the National Labor Relations Board and the United States Conciliation Service. But many parts of the proposal could become operative, with or without legislation, in a relatively short time, and beginnings in all parts could be made very soon.

From the standpoint of intended effect, the methods of making beginnings and of obtaining adherence to such policies would be very important. Special conventions of the federations of unions, with properly loud and intermittently persistent beating of the drums of publicity, would seem to be required.

## VII

A number of economic-political policies have been suggested here to the leaders of the American labor movement which in my judgment are practically realizable. These policies should be helpful to organized

labor in securing social acceptance and in achieving social responsibility commensurate with the power and authority that has been delegated to it. They should also make a contribution to the attainment of the best kind of social security—a large, well-distributed national income based on full utilization of resources and on democratic participation of all groups.

It may be objected that the suggested program implies an identity of labor's interests with employers'; that there has been no discussion or even mention of employers' economic-political-democratic responsibilities; that militant power is the only thing employers respect and that adoption of such a program by labor would be to admit weakness; or that the labor movement is being asked to commit suicide. I find nothing compelling in such objections. Surely we need not argue here the question of identity of interests. There is both identity and divergence of interests, and my aim has been to apply responsible tripartite democratic methods to further the one and minimize the other. Certainly employers have their own obligations. My views thereon have been expressed in other places; this paper has purposely been confined solely to unionism. Surely the strength or weakness of the labor movement depends on many other things than the adoption of such a program. Indeed espousal of these positive proposals would indicate mature strength rather than weakness. And most assuredly I have not dreamed of suggesting any kind of self-mutilation to labor. On the contrary, I have tried to indicate ways of living a long and prosperous life, avoiding cirrhosis, sclerosis, and all sorts of poverty.

We are told that isolationism is done for, that under modern economic and political conditions no one can live successfully to himself. If this is true of nations, it is also true of individuals and of groups within a nation. It is true of organized labor. I do not mean to say that unions have been hermits or isolationists in any literal or narrow sense. As organizers of employees and as collective bargainers with employers, they have not only experienced but also sought relations with other groups. Nor do I mean to say that all unions have been isolationists in any broad sense. But too many unions and their leaders thus far have compartmentalized their relations and shunned contact with the fundamental forces and issues of our time. They are among those who in the broad sense have been isolationist. They are among those who are challenged to be enlightenedly selfish. And it is they who are among those who will have a tremendous part to play in determining whether economic-political goals consistent with American resources and American democratic ideals are to be attained.

# WAGE REGULATION IN POSTWAR AMERICA

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It is not proposed here to discuss wage regulation in postwar America in terms of theoretical solutions for hypothetical problems. On the contrary, the significance of wartime wage regulations is given most attention. These regulations, so commonly misunderstood, should be clearly perceived as a prerequisite to a consideration of postwar wage policies. It is believed, moreover, that most Americans are interested in learning what can be done in postwar years to minimize the extent of governmental regulation of our economic life, including the regulation of wages.

## I

In prewar days, direct governmental regulation of wages was primarily limited to the establishment of minimum hourly wages to assist in eliminating substandard conditions of living. The National Recovery Act did, for a short time, extensively regulate labor costs in some industries but the results were neither effective nor promising. There were also governmental programs to protect standard wage-scales from the forces of unregulated competition such as in the Davis-Bacon Act for the building trades and in the Guffey Act for the coal industry. The basic governmental regulation affecting wage policies, however, was indirect. Reference is to the encouragement of collective bargaining under the National Labor Relations Act. This Act also recognized collective bargaining as the institution best adapted for the determination of wage policies whenever the employees are organized into unions of their own choosing.

Wage regulation in prewar America primarily consisted, therefore, of (1) the encouragement of collective bargaining; (2) the specification of minimum hourly rates to correct substandards of living; and (3) specific regulations to meet the particular problems of certain industries.

## II

The national wage policies of a peacetime economy were not adapted, of course, to the mobilization of national resources for war. The war economy of the past two years was dominated by scarcities, not only of civilian goods but, more important, of life-saving military supplies. Cost considerations were therefore of secondary interest, either to the nation fighting a war for its existence or to producers who had a virtually guaranteed demand for all goods they could turn out. Vast increases in purchasing power occurred while production expanded al-

though the supply of many important consumers goods was curtailed or entirely shut off. Manpower shortages resulted not only from the creation of an armed force and because of the difficulties of shifting employees to new areas and to new industries but also from the increased demand for war materials.

Great concern was expressed about the widening gap between purchasing power and the supply of consumer goods. Programs effectively to control the growth of this gap have not generally been developed as respects either taxation or savings. The pent-up force of unused purchasing power has, nevertheless, not erupted. It may well have done so if there had been a pell-mell race between wages and prices. This could easily have created a demand for goods not merely to meet individual needs but to provide some measure of security. An inflationary movement of this sort would have jeopardized the maximum production of war goods and resulted in a haphazard distribution of available consumer goods. Not the least important consequences of a pell-mell race between wages and prices would have been in a staggering increase in the cost of the war to be bequeathed to future generations.

Such considerations led this country not only into extensive regulation of wages but into the widespread regulation of all phases of our economic life. There were no guides based upon experience. There was only a determination to do everything necessary to win a war against brutal enemies and at the same time to take every intelligent step to minimize inflationary tendencies.

The year of 1943 was filled with great events and historical moments. One of the great facts of 1943 is that inflationary forces were held in check.

## III

The wartime economic policies center about the program to stabilize all prices and all wages. Initially formulated by the President on April 27, 1942, a part of the stabilization program was later adopted by Congress in the Act of October 2, 1942. Appraisals of the results of the stabilization plans vary with one's definition of stabilization and with the measures of the relative changes in wages and in prices which are used. A detailed discussion of these particular questions cannot now be undertaken. It is pertinent to the purpose of this paper, however, to review the program of wage regulation as carried out in wartime America because of its significance to postwar policy questions.

In the development of a national wage stabilization program, work was undertaken in a virtually uncharted field. Our knowledge of wages, of the forces behind their fluctuation, and of their intricate interrelationships, is really not very extensive. It had long been assumed in

many quarters, for example, that there was something quite fundamental in saying that "within noncompeting groups, all other things being equal, wages tend to be equal." One does not work very long in setting wage rates, however, before contacting strong forces which act to create disparities between wages even within interchangeable groups of employees. The forces which press toward disequality are evidently more potent than those which tend toward equality since, at any time, the dominant characteristic of industrial wage structures is a great and wide diversity of wages. Perhaps this is because "all other things" are seldom and perhaps never equal.

Wage regulation on any widespread scale must center largely about differences in wage rates and the determination of a myriad of complex rate relationships. In a surprisingly large number of instances, action taken to equalize related rates serves not to stabilize the rates at all but only to generate an insistent demand for the "restoration of historical differences." This force is often particularly strong even as between interchangeable groups of employees and during wartime when there is no unemployment.

Stabilization does not mean the equalizing of rates. Nor can it mean that all wage-rate relationships would be "frozen." Some changes in such relationships are necessary to account for changed economic conditions and to use certain wage disparities as an allocator of manpower. Wage regulation is not a simple matter even in wartime when there are also programs for extensive regulation of prices, production schedules, manpower movement, profits and salaries. The complexities of the problem increased naturally when it became necessary to restrict both the process of collective bargaining over wages and the wage-determinations customarily made by employers. Use could not be made, therefore, of the established procedures for setting wages.

## IV

Collective bargaining, nevertheless, has been materially strengthened as a democratic institution during the first two years of war. The maintenance-of-membership clauses, evolved by the War Labor Board, not only settled the serious question of union status for the period of war, but insured that unions and collective bargaining would be preserved despite the serious threats to their existence that arose with the war and with economic regulation. Comprehensive labor agreements have been developed in many plants and industries where only casual and doubtful arrangements previously prevailed. Wage-rate schedules have been embodied in agreements, often for the first time. Grievance procedures to take care of the day-to-day problems of industrial relations are slowly but surely being made more adequate. Arbitration has been

widely adopted and commonly accepted as a proper means of settling many disputes. These developments, and many more which might be mentioned, are building collective bargaining into a well-developed institution despite the restrictions imposed by wartime regulations upon wage changes. It is also of moment to recall that all the terms of collective agreements, except for wages, are subject to being worked out by bargaining between the parties themselves. There is, therefore, a not inconsiderable area in which unrestricted collective bargaining is being undertaken.

It is to be hoped that collective bargaining will be an institution sufficiently strong to carry a major part of the postwar industrial relations program. If this is so, extensive wage regulation may be unnecessary in postwar years.

## V

It is now necessary to consider the fundamental details of the wage-regulation program which has been developed as a phase of the economic stabilization program in wartime.

Some forces, acting to bring about wage changes, have such a widespread and permeating effect that they may be compared to ground swells which powerfully move general levels upward or downward. In recent years, these forces have frequently resulted in uniform "across-the-board" increases to all the units in an industry or throughout large groups of industries. They have been in response to increased costs of living, increased profits, decreasing reserves of manpower or to organization for collective bargaining processes.

Other forces often necessitate particular wage changes within the general level. They may be compared to crosscurrents or to surface movements. At any general level of wages, crosscurrents exert frequent pressures for a change in the relationship between the wages paid by plant A and plant B. There are also surface movements acting to change the relationship between the rates paid within a plant to occupation X and to occupation Y. A lack of balance between the wage rates of two particular plants in an industry will persist even after ground-swell pressures have resulted in a general wage increase to all the plants in the industry. Similarly, a real intraplant inequality between occupational groups remains even after a general "across-the-board" wage increase has been provided to every employee in the plant.

As the existing wage stabilization program has evolved, it has been essential to provide not only for a limitation upon changes in the general level of wages, but also to provide a basis for making necessary changes in interplant and intraplant wage-rate relationships. A simple

stabilization program would be wholly inadequate if it failed to provide for the various types of wage adjustments which are constantly being made at one point or another in the national wage structure.

The Little Steel formula, related to general wage increases, and the wage bracket program, related to interplant differentials, are the basic parts of the present stabilization program. Changes in intraplant wage relationships may also be approved, as long as production costs are not appreciably increased, on the basis of job analysis or by comparison with prevailing relationships between jobs in other plants. It has also been recognized that grossly inequitable rates should be corrected, even in wartime, and provision is made for the approval of increases in wage rates necessary to correct substandards of living. What has been the experience of the National War Labor Board in its efforts to stabilize wages along these various lines?

*The Little Steel Formula.* The so-called "Little Steel formula" allows general wage increases to appropriate groups of employees as long as such increases do not exceed a total of 15 per cent on the average since January 1, 1941. This limit was not effective as a restriction in all industries. From July, 1942, to October, 1942, the Little Steel formula was used by the War Labor Board in deciding such disputes over general wage increases as came to the Board for determination. Prior to October 2, 1942, however, there were no governmental restrictions upon wage increases voluntarily agreed to by employers and unions, or inaugurated by employers. The control of general wage increases was not uniformly effective, therefore, during the first ten months of war. Widely varying general increases were made during these months by different plants and in different industries.

It was on April 27, 1942, that the President announced a seven-point stabilization program which, in effect, provided as a general policy that no further general wage increases were to be made except to correct gross inequities. In carrying out its responsibilities under that program, the War Labor Board concluded that industry-wide or plant-wide groups of employees should receive average wage increases in straight-time hourly rates totaling at least 15 per cent since January 1, 1941, before being required to forego the right to further general wage increases. Many groups of employees, accounting for approximately two-thirds of all manufacturing wage earners, had already received general wage increases in excess of 15 per cent. About one-third of the manufacturing wage earners had received either no general wage increases at all or less than 15 per cent since January 1, 1941. These latter groups, it was determined, should be afforded an opportunity to receive further general wage increases as a first step in effectuating the rigorous

wage stabilization policy. The Little Steel formula actually established, therefore, a minimum general wage increase as a basis for stabilization and not a maximum limit as is sometimes presumed.

The Board believed that its action in the Little Steel cases was a necessary step to bring within the stabilized general wage level the wages paid to the minority of employees whose wages had lagged most on the upswing since January 1, 1941. In addition, such flexibility was essential to the maintenance of a reasonable balance in the national wage-rate structure. Previously existing wage-rate relationships between industries had been disturbed largely because of the different times when upward adjustments were made in various industries and by various companies. They were in the midst of a process of realignment. In the absence of restrictions, many of the relatively low wage rates would have been brought into line with the new general wage level which was in the throes of being created. Such a highly dynamic situation could not abruptly have been made static without interfering with the production program. It would have been impossible and undesirable, however, to attempt either a full restoration of the relationships which existed prior to January 1, 1941, or to approve general wage increases so as to level off at the highest points already reached by some industries. The Little Steel formula was designed, therefore, to provide a means for adjusting these wage rates which had lagged behind the general procession despite the fact that since April 27, 1942, the national program called, in general, for the maintenance of existing scales of wages. It was concluded that an adjustment of the wage rates to the extent of the 15 per cent limitation could be justified because the cost-of-living as shown by the Bureau of Labor Statistics' index had also risen by approximately 15 per cent.

Dissatisfaction with the Little Steel formula arises from the fact that those employees who have received only the minimum allowable general wage increases are not relatively as well off as those who received greater increases prior to the effectuation of the wage regulation program. These employees have been limited in the extent to which they could catch up with those in the van of the wage movement. In addition, the cost of living is now, according to the Bureau of Labor Statistics' index, about 24 per cent above January 1, 1941. On the other hand, the Little Steel formula relates to straight-time hourly rates, and not to weekly take-home, and there are substantial groups of employees which have not yet "received their 15 per cent." Some employees whose wage rates lagged have, moreover, received general wage increases in excess of 15 per cent whenever this was found to be necessary for the correction of substandards of living.

Some proposals for a modification of the Little Steel formula, such as suggestions that the allowable limit on total general wage increases

be set at 20 per cent instead of 15 per cent, actually suggest additional selective wage increases and not a further round of general wage increases.

*Interplant Wage Relationships.* Variations in wage rates beween different plants frequently represent an established and a stabilized relationship. Even these variations may be subject to change from time to time, however, as changes occur in the causative factors, such as ability to pay, area wage levels, and the local labor market. These are the cross-currents affecting wage relationships.

A comprehensive wage stabilization program in this time of war has to provide not only for necessary adjustments of interplant rate relationships in order to maximize productive efficiency, but also for adjustments within the existing general level of wages if inflationary tendencies are to be controlled. There would obviously be a slow but steady rise in the general level of wages if rates between plants were first equalized and then further adjusted to restore historical differences. On the other hand, relatively low wage rates which nevertheless drew sufficient manpower to a certain plant when there was a readily available labor supply may be entirely obsolete at a time of manpower shortages. If such a plant is to be counted upon to supply war goods, its wages must be brought into a closer alignment with the great majority of plants in its area.

Prior to April 8, 1943, when Executive Order No. 9328 was issued, the National War Labor Board was free to adjust interplant rate relationships through the exercise of its judgment based upon data concerning (a) the relationship between the wage rates paid in various plants of the same company; (b) the relationship between wages paid by companies in the same industry regardless of area; and (c) the relationship between plants in the same labor market area regardless of industry. The weight given to each factor in particular cases obviously could not be precisely evaluated. The problem before the Board was to differentiate between those "sound and tested" rate differentials which should not be changed even in wartime and the disparities which had to be minimized in order to create a balanced rate relationship. Attention to such matters in time of war, moreover, had to take cognizance of two all-pervading factors: the relationships between wage rates paid by individual companies in particular labor market areas, irrespective of industry, became increasingly important as manpower problems mounted at a time of guaranteed demand for all products; there are indications that variations in wage rates between plants in the same industry, as well as in the same area, tend to widen when ample manpower reserves are readily available but to narrow in a period of manpower shortages.

The principal effect of Executive Order No. 9328 was the withdrawal

of the authority of the War Labor Board to approve further corrections of interplant inequalities. The May 12, 1943, clarifying order of the Director of Economic Stabilization, however, again recognized the necessity for wage adjustments in interplant relationships. Under that order they were limited to a minimum, however, and had to be determined in accordance with an objective standard rather than through the exercise of judgment. In the first place, interplant wage adjustments were virtually restricted to rate relationships by industries within particular areas and, secondly, they were to be made by reference to so-called "established brackets of sound and tested rates for occupational groups in each area."

The various Regional War Labor Boards were called upon to specify for particular occupations in each industry, and in each labor market area, a range of wage rates encompassing all the various rates being paid which were deemed to be "sound and tested." This compilation has been almost completed. All existing wage rates within the brackets are to be maintained. Only those rates which are below the minimum of the bracket are subject to change for the adjustment of interplant relationships and then to a point not above the minimum of the bracket. In actual operation, the minimum of the bracket rates are approximately 10 per cent below the average wage paid in an area for a particular type of work. In general, therefore, interplant wage relationships can now be changed only as respects occupational wages which are 10 per cent or more below the average wage paid in the area and then only to within 10 per cent of the average wage. The brackets of sound and tested rates, which are considered as stabilized rates, embrace the large majority of rates being paid. Provision was made for changing rates to a point above the minimum of the bracket only in rare and unusual cases where a greater change in interplant relationships was clearly necessary for the successful prosecution of the war.

*Intraplant Wage Relationships.* At any general level of wages, and even though there may be no question of interplant relationships, problems frequently arise concerning the intraplant relation between the rates paid for occupation X as compared with occupation Y. The absence of a proper internal rate alignment may often be more destructive of employee morale than interplant differences. One of the most surprising findings incident to the wartime regulation of wages is that large segments of American industry have neglected the establishment of job classifications and rate schedules designed to insure a reasonably balanced internal wage-rate structure.

The minute aspects of intraplant wage relationships cannot be worked out by government regulation if local conditions, which are compelling, are to be taken into account. Executive Order No. 9328

permits the reclassification of jobs to bring about a proper internal rate relationship, as long as there is no resultant "appreciable increase" in the costs of production. The War Labor Board, through its General Orders, has encouraged the installation and refinement of job classifications and rate schedules by management and through collective bargaining. It has been found necessary in particular instances, however, for the Board actually to specify detailed classification and rate schedules in order to resolve a labor dispute which threatens to interfere with the successful prosecution of the war. No government agency should undertake to work out management problems of this sort on any extensive scale. It goes almost without saying that the numerous and intricate intraplant rate relationships can best be developed by those familiar with the jobs and with the people in each plant. Collective bargaining, using the results of job studies, is the process for considering intraplant wage relationships whenever employees are organized into unions.

*Substandards of Living.* The correction of substandards of living has always been a justifiable reason for wage increases under the wartime stabilization program. The Fair Labor Standards Act presently requires a minimum wage of 30 cents per hour although virtually all industries in interstate commerce are now subject to a 40 cents per hour minimum wage because of action taken by industry committees under that Act. The War Labor Board has no power to order any minimum wage for general application, but it will approve voluntary wage increases up to 50 cents per hour to correct substandards of living and in so doing it will make the minimum adjustments in interrelated job classifications which are necessary to maintain productive efficiency.

The tremendous growth and change in the composition of national production, in response to the demands of war, has resulted in significant departures from prewar standards of employment, wage rates, hours of work, total earnings, and living costs. Wartime wage policies center about stabilization to minimize inflation while allowing sufficient flexibility to adjust wage-rate relationships in the interest of maximum production. The major problems of the transition to a postwar economy will be generally similar in nature. They may be concerned, however, either with the avoidance of a rapid and cumulative inflation or of a sweeping and cumulative deflation. The creation of new relationships in the national wage structure will be particularly urgent as adjustments are sought, not only to liquidate the restrictions imposed during the war, but also in response to the new set of economic conditions which will be faced.

Shortened work weeks will bring proportionately greater decreases in weekly take-home since overtime pay will be lost. Basic wage rates have been maintained, however, more closely to prewar levels than

either average hourly rates or take-home wages. It may be anticipated that, by and large, there will be no drastic changes in straight-time hourly rates. At any event, such a prospect appears to be likely unless there develops a ground-swell movement in the cost of living. Even should there be no fundamental change in the general level of wage rates, intercompany and intraplant rate relationships will almost inevitably be subject to extensive readjustment as competitive relationships again come into operation. These necessary adjustments will not be amenable to general over-all regulation but will require a series of programs worked out for individual situations. They should be based upon the economics of particular industries and upon the status of individual companies.

One can certainly not anticipate how government regulation could possibly be effective in making the postwar wage adjustments which will be necessary, even if there is no general movement of wages, at a time when the right to strike will again be freely exercisable and when, it is hoped, there will be a marked relaxation of governmental regulation of price, production, and consumption. And underlying every postwar problem is the question: How can employment be maintained? No one can now forecast the effect of this question upon wage-rate policy.

The inevitable maladjustments and pressures in the postwar years will undoubtedly give rise to numerous demands for governmental regulation of wages. There may be problems so acute, moreover, as to necessitate some governmental regulations. Before jumping to any hasty conclusions about such questions, it is well to recall that, in peacetime America, the national labor policy which was finally evolved recognized collective bargaining as the institution charged with determining the principal questions of wages. Wartime regulations have interfered in many ways with the normal use of collective bargaining but they have also developed it as a useful institution in many other ways. It has a vital function to perform in postwar years. To a large extent, the degree of governmental wage regulation which will be demanded, and perhaps which will be necessary in postwar years, rests largely upon the efficacy of collective bargaining.

Many of those who want to see the postwar wage problem met primarily by collective bargaining rather than by government regulation, are motivated partially by a realization that extensive wage regulation may well mean an extensive regulation of all phases of our economic life. One of the most urgent aspects of postwar regulation of wages is the need now to develop collective bargaining relationships so that they can assume heavy postwar burdens. This emphasis upon collective bargaining is not only in line with America's prewar labor policy but is prompted by a realization of the complexities of the problems involved

in working out wage relationships. Most of them can best be worked out by the parties directly affected. Wartime regulations have, however, made clear the importance of wage-rate differentials between various plants in the same industry or the same area. It is concluded, therefore, that the blueprinting of the postwar job of collective bargaining should not preclude careful attention to the possibilities of industry-wide collective bargaining in determining interplant relationships. In addition, if it is to attain the fundamental position assigned to it in prewar years, collective bargaining must be developed with full consideration to the ways of achieving high and secure wages to employees, reasonable profits to employers, and relatively low costs to consumers.

The importance assigned to the role of collective bargaining in meeting the postwar wage problem is based upon a conviction that wartime regulation does not point the way to a peacetime pattern. If collective bargaining is developed as the foundation of postwar labor relations, then governmental wage regulation will most likely follow the pattern of the prewar years rather than that of the war years. This would indicate the need of attention to minimum wage legislation designed to correct substandards of living and the likelihood of requests for specific legislation to meet the economic problems of particular industries. One cannot now visualize what lies ahead in these directions. One can now, however, note the possible use of the tripartite agency as an effective mechanism in dealing with such matters.

The tripartite agency to deal with economic matters, and particularly with wage questions, is gradually evolving as one of the effective instruments of government. Its use—a logical extension of collective bargaining—presupposes that detailed questions of industrial economics can best be resolved through discussion of those directly representative of the conflicting interests of those concerned. The procedure was first attempted, on any large scale, in the committees which developed industry codes under the National Recovery Administration. The results were not very salutary, to say the least, but some experience with a new procedure had been attained. The next significant use of the tripartite machinery was in the so-called "industry committees" which determined the minimum wages for particular industries under the Fair Labor Standards Act. The results of this second use of the tripartite mechanism were quite encouraging. Then the National War Labor Board was established with a tripartite composition, and, in my judgment, the efficacy of such a type of organization became fully evident. The stresses and strains of the moment should not be permitted to obscure the strength of the War Labor Board, derived from its tripartite composition, in developing a well-rounded and workable program under adverse conditions. Its method has been to charge representatives of

industry, labor, and the public with equal responsibility, not only for settling controversies and evolving policies, but for carrying out the conclusions reached by the majority. The tripartite process embodies the essence of our democratic wisdom. On the record, there are strong reasons for believing that in the tripartite board there is gradually evolving a new type of administrative arm of government which can be of inestimable value in resolving wage questions—and perhaps economic questions in general—under a general policy established by the legislative branch. Its usefulness should not be overlooked when a program for postwar wage policy is under consideration.

The suggested program for treating postwar wage problems is primarily one under which government regulation on any large scale is quite unnecessary. There are not many who still believe there can be or should be a return to the unilateral determination of wages by employers as a standard practice. A choice must be made, therefore, between dependence for wage determination in postwar years upon collective bargaining or government regulation. There are real difficulties involved in making collective bargaining work. This is, however, the task which lies ahead as we strive to preserve and to protect economic democracy. With an effective collective bargaining system, and perhaps a fuller use of the tripartite administrative body in developing the government regulations considered to be essential in limited areas, the mechanism is available to resolve postwar wage questions in a manner appropriate to a democracy.

## DISCUSSION

DAVID A. McCABE: I shall devote my time to some of the questions raised by Professor Taylor's interesting and highly competent paper.

I agree that there is not much point in discussing now the matter of general wage regulation in the real postwar period. The question of regulation is one that is pertinent for the intermediate or transitional period—the period that will begin when production and distribution are no longer directed primarily to the winning of the war. It is a period that cannot be easily defined in terms of hostilities or armistice; it is an economic interval which will come after the end of a period in which objectives are clear and methods relatively simple and before we have settled into the new peacetime basis.

Presumably we shall come to the beginning of the transitional period with some kind of wage regulation still in force. How long that hold-over stage will continue will depend, for one thing, upon how long price controls and rationing are continued. The wage stabilization program was a consequence of the program for controlling prices; it is not likely that it will be abandoned before the necessity of price control has passed. Meanwhile the purpose of wage regulation will presumably remain the checking of inflation.

The crux of our question is what we shall do about wages when the need of curbing wage increases has passed. Shall we just "let the old cat (regulation) die"? Much depends upon whether there follows either a demand for a general reduction in wages or the multiplication of demands for particular wage reductions as a means of effecting readjustments to changed demand for products and of expediting the transfer of workers to other jobs, or at least out of the jobs they have had. We may face some requests for particular wage reductions even while the general policy of curbing wage increases is still in force. Will such requests grow in number and coverage to represent a considerable lowering of average wages and develop into a general demand for wage reduction?

Professor Taylor suggests that the issue of a general reduction in hourly rates may not be presented, unless there is a considerable reduction in the cost of living. However, we must face the prospect that it will be. Reduction in weekly earnings through reduction in the number of hours worked and reduction in average hourly earnings through the disappearance of overtime premiums will not necessarily avert a demand for reductions in basic hourly rates. If such a demand is made it will probably be based on the necessity of reducing costs to get orders; costs, not worker income, will be offered as the determinant which must be followed; the necessity of preventing unemployment will take the place now given to the necessity of preventing inflation as the consideration for which other yardsticks must be brushed aside; the lowering of hourly rates will be advocated as the only means of preventing a still greater reduction in weekly earnings.

A general demand for wage reductions, if it comes, is liable to precipitate a strike crisis. Would the country permit the issue to be decided by economic combat? We may, of course, carry over the War Labor Board, or a successor,

at least as an agency of compulsory arbitration, into a period of disputes over wage reductions. The task of a compulsory arbitration board under these conditions would be more difficult than that of a straight stabilization board. It would have to meet the types of wage problems that would confront a regulatory board plus the complicating factor of reductions in wage rates by agreement; that is, without a formal "dispute." Variations in wage rates within the same industry are likely to cause more trouble as competition for sales displaces competition for labor within the local area in the employers' minds. If reductions by agreement should threaten the maintenance of union rates or the jobs of those in unionized plants, there would probably be a demand for legal prohibition of wage reductions without the approval of the board, on the ground that this is necessary to prevent unfair competition and to avert depression.

If a fight over reductions comes and there is no board, we shall probably have, for a time, executive intervention in the major disputes. If executive intervention is successful enough to prevent the enactment of a compulsory arbitration law or a wage stabilization law it will be because the executive exerts sufficient pressure to secure the acceptance of terms suggested by the executive. This kind of wage regulation is less desirable than wage regulation by a board. But either is better than a system in which decision by a board of presumed final jurisdiction is modified as the result of executive intervention.

Another possibility is an agreement between representatives of labor and representatives of industry on a wage policy, on a national basis, to hold for a specified period. This would be collective bargaining on a truly national scale. Industry-wide bargaining is to be encouraged, to be sure, but the issue of "holding the line" on wages or a general movement of wages should be met in collective bargaining that is as general in coverage as the issue itself. The spelling out of the answer, industry by industry, is likely to lead to a policy of watchful waiting that will hold up production even if it does not lead to strike threats or strikes. But if agreement of national scope is to be reached the attempt should not be postponed until after the issue has been joined. And it would be well for the initiative to come from the parties themselves.

A nation-wide agreement could not be implemented without a board to pass on requests for particular wage changes from the level agreed upon or outside an agreed-upon range. This could be a joint board, or a projection of a joint board like the War Labor Board of 1918. Its members, including its co-chairmen, could be selected by the parties to the agreement but its expenses, including those of regional or district offices if these are necessary, could be met by the government.

The board would have to dispose of the same types of demands for exceptions that a regulatory board with legal sanctions would have to meet. However, a board of this kind could allow more flexibility in settlements by collective bargaining down the line than a board acting under a legislative or executive directive could afford to allow. The decisions of the board would not have the force of law. It would have to rely for observance upon the pledges of the parties to the agreement and upon the pressure of public opinion

on those not in the organized groups represented in the making of the agreement. If it were successful in avoiding both major strikes and government regulation of wages during the transitional period it would score a great triumph for collective bargaining and union-employer co-operation.

If we have to come to compulsory arbitration or the direct legal regulation of wages through a board, I am not at all sure that the board should be tripartite in composition, as contrasted with a board made up exclusively of "public" members. I am speaking of a permanent board with full power to make legally binding decisions, not of a panel or committee for investigation and recommendation. Experience with a tripartite board in time of war is not conclusive on this point.

If labor and industry have not had a chance to work out an agreement on a national wage policy, a tripartite board might be able to reach an agreement on policy that labor and industry would, in general, accept. On the other hand, if the board should fail as a policy-making board to reach an agreement, the difficulty of enforcing its decisions might be greater than it would be if the board were an exclusively "public" board. Dissents from the policy pursued by the board by one of its component sides seem to discourage acceptance of its decisions more than do protests from without; the public members may be put in the position of "siding with the other side" instead of being regarded as merely mistaken. The experience with a permanent tripartite board under Title III of the Transportation Act of 1920 was not a happy one. That was not a board of compulsory arbitration but its decisions were intended to have the sanction of public opinion. Furthermore, if the dissent is on a matter that the dissenters regard as vital, it may lead to the withdrawal of the representatives of the dissenting side from the board, as in the case of the National Defense Mediation Board of 1941.

The argument is much stronger for tripartite composition if the board has to implement a policy already determined by the legislature or the executive. The tripartite membership may help to cushion the impact of an objectionable policy for the objecting side. Undoubtedly, the labor and industry members of such a board can furnish helpful technical, or even diplomatic, assistance to the public members in the execution of the directive from without. The question is not one as to the usefulness of industry and labor members so much as one as to how long important figures in industry or in the labor world will be available for such service if the wartime pressure is lacking.

David Kaplan: I find myself in agreement with both Dr. Taylor and Dr. Daugherty on fundamental things. This is particularly true as far as goals are concerned. They both believe deeply in the collective bargaining process as a fundamental method of improving labor relations, and I share that faith. They both believe in the extension of the tripartite machinery representative of industry, labor, and government as an effective instrument for evolving economic policies affecting all three.

I look upon the acceptance of this tripartite machinery as a hopeful sign of future co-operation. It provides a means of cultivating mutual understanding of the problems confronting each, and an avenue through which realistic

planning of economic welfare can be promoted. These tripartite agencies could profitably be developed as economic councils of industry, labor, and government on local, state, and national levels.

There are many problems that transcend the immediate job interests of workers and business interests of employers that affect business stability, employment, wages, and prices. It is in dealing with such forces that labor, industry, and government would find the tripartite machinery most effective. Each would learn from the other the impact of its particular patterns of action on the economy as a whole.

That of itself would be a large step towards the molding of an economic behavior pattern which would be honestly oriented towards the goals of full employment at high and secure wages to employees, reasonable profits to employers, and relatively low costs to consumers of which Dr. Taylor and Dr. Daugherty speak.

Dr. Daugherty's paper covers an extensive territory in the field of labor relations and raises more questions than it answers—probably deliberately so. My main criticism of Dr. Daugherty is that he seems to overlook the basic fact that despite the growing acceptance of collective bargaining, one of the chief functions of a labor leader still remains that of keeping the organization together and keeping it unified against the forces that threaten to destroy or weaken it. This, along with the promotion of the job interests of the membership, constitutes the fundamental task of the labor leader. To the labor leader the task of keeping the organization together and unified and promoting the job interests of the members is all one task, for he cannot conceive how the job interests of the worker member could best be promoted without the support of a strong, stable organization. An appreciation of this is the most important key to the understanding of the patterns of union behavior. Viewed from such a perspective the criteria discussed by Dr. Daugherty for judging whether unions are good, bad, or indifferent seem artificial and utopian.

Any organization can interest itself in housing, credit unions, political programs, and other social activities, but it is precisely the absorption with the job interests of its members that distinguishes a labor organization from other organizations.

This does not mean that labor organizations should not participate in these other movements and should keep its horizons narrowed strictly to the job, but it is going to be these narrower interests that will condition the thinking of labor leaders.

The "good" labor leader as reflected in Dr. Daugherty's paper is really an economist with all the economist's fervor for the long-run interest, flexible prices, and abstract economic principles.

I fear that once the labor leader became an economist he would soon cease to be a labor leader. And in speaking of labor leaders I am not thinking only of the two hundred or so presidents of international unions but of the many thousands of business agents, delegates, and officers of local unions who have even more effect in influencing union attitudes on wages and working rules.

Were you to ask the average union member whether his union is good, bad, or indifferent his answer would be connected most definitely with how the

union served his job interests and his most immediate job interest at that. This does not mean that labor leaders and labor organizations have no wider interest, but they gain these wider interests mainly as radiations growing out of the job interest. It is precisely to further the intelligent cultivation of these wider economic interests that I favor the tripartite machinery, for labor leaders learn not so much from lectures or economic treatises but rather from participation in joint projects.

With the affirmative suggestion Dr. Taylor has made in his paper I am in hearty accord. I believe that wage regulation by government in the postwar period should be confined to questions of minimum wages and to special industrial cases.

As already stated, I share Dr. Taylor's faith in the tripartite machinery as a means of evolving economic policies and carrying them into execution.

Since the rest of Dr. Taylor's paper deals with the policies administered by the War Labor Board and is, for the most part, descriptive, one finds no room for issue. I am therefore going to bring in a provocative element myself.

I think that the War Labor Board should now revise its Little Steel formula. I think it would have been more satisfactory from the beginning to have adopted a program which permitted wage increases in line with actual cost-of-living increases. I believe this would have been wiser, not only in the interest of better labor relations, but also in the interest of a sound stabilization policy. As it stands now wage rate increases have been more effectively limited than price increases. Mainly it requires only negative administrative action to freeze a wage scale, while it requires affirmative Congressional action in the form of subsidies to put and keep many types of commodities on the market at stable prices. The present wage formula does not put sufficient pressure upon those in Congress and the Administration responsible for price policy; the suggested formula would provide this pressure.

In such a policy you could keep the Board's general practice of specifying the increase in a uniform cents-per-hour for all employees of a bargaining unit in order to give the advantage to the lower paid instead of the higher paid which the percentage rise method favors. The whole policy could be stated as an increase in cents per hour for each point of increase in the cost-of-living index, and thus further simplify its application. For example, if we could conclude that $1.00 an hour at 40 hours per week would in January, 1941, provide the minimum for a decent American standard of living, we could allow 1 cent an hour increase for each point of rise in the cost-of-living index.

In order to make the program administratively workable, the Board should provide that in the interim before the expiration date of agreements employers could pay any cost-of-living increase not already a part of the wage rate as an added bonus. After the contract expires the parties would determine through collective bargaining whether to keep the increase as a cost-of-living bonus or to abandon the bonus and increase the wage rate to yield the same amount.

The amount of increase per point could be reviewed from time to time to determine whether any changes are necessary to give effect to factors which increase living costs that are not reflected in the cost-of-living index. Public

hearings on this matter would provide a forum through which all labor could be heard, and statements and decisions of the Board on the question would be of great educational value, not only to labor, but to all elements of the public. As it is now, the feeling is growing among workers that the War Labor Board is nonrealistic, unjust, and callous to one of the most vital factors touching on their wages today—the decreased purchasing power of the dollar in their pay envelopes. No dissertation on inflationary spirals or inflationary gaps can remove that feeling so long as the Board, except for perfunctory reference to the Little Steel formula, ignores it from any further consideration.

Relating wages with the cost-of-living index should not be carried over as a peacetime policy. Labor organizations have fought it vigorously because it limits collective bargaining and freezes workers' standards.

The War Labor Board is increasingly being placed in an anomalous position in its function of settling labor disputes as more and more of these disputes will now arise as a result of the very wage policy administered by the Board.

The 15 per cent Little Steel formula was adopted at a time when it was felt that the price line would be held. This line was not held. The cost-of-living index was never rolled back to October, 1942, as promised to labor by Administration forces. Though some prices were rolled back through use of subsidies, they were offset by increases of other prices and the net result is that the U. S. Department of Labor cost-of-living index now shows a 24 per cent increase above the January, 1941, level.

It seems to me that the Board should face this honestly and revise its Little Steel formula either through raising the ceiling or, preferably, through relating wage increases directly to the cost-of-living index.

If it is to remain an effective agency in labor relations the Board will either do this, or resort to subterfuge such as giving increases in lieu of lunch time, or in lieu of overtime, or by other more dubious means that human ingenuity can devise. Once it departs on such a program everyone will know that it is no longer applying a principle impartially to all, but is yielding to pressures. When that is discovered the pressures will not be long in coming.

# SOCIAL SECURITY

## SOCIAL INSURANCE IN EVOLUTION

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### I

Few topics of economic study present a more perfect example than social insurance of the interrelationships between economics and the other social sciences: sociology, social psychology, political science and history, using the latter word in the sense of the study of institutional evolution. Few make greater demands on the ability of the student accurately to diagnose and specifically to state his premises concerning the prevailing temper and social psychology of the period to which his generalizations relate. Few illustrate better the need for a dynamic and evolutionary approach to the study of social institutions. Finally, few topics of study expose the economist to greater temptations to introduce implicit value judgments into his "purely theoretical" analyses.

It is part of my thesis that the institution of social insurance is a social invention which was brought into being to perform a specific function in a specific economic and social environment. As I have said elsewhere, "It was the ideal instrument for effecting a significant break in the deterrent treatment of insecure workers, because its apparent analogy with private insurance made the change acceptable to a society which was dominated by business ethics and which stressed individual economic responsibility."[1] Its forms were necessarily conditioned by the job to be done and by the social and economic environment. But, and this is the second part of my thesis, social insurance is a dynamic invention in the sense intended by Gunnar Myrdal, when in his recent book he urges social scientists to pay more attention to "those inventions which have the greatest promise of moving the society in a desired direction, and to seek *social* inventions which would modify economic organization and the effects of mechanical inventions."[2] For I believe it can be shown that the social invention of social insurance has modified the environmental factors that form part of the premises of the economist. In so doing it has not only broadened the prevailing concept of the job to be done, and made possible the use of new social techniques, but the institution itself has undergone significant changes of form. These changes within social insurance itself and in the environment in which it operates must be always held in mind if the analyses

[1] *British Unemployment Programs*, p. 316.
[2] *An American Dilemma*, p. 1053.

of economists are to be relevant and if their advice on policy is to be fruitful.

From this point of view I suggest that, up to and including the present, it is possible to distinguish at least three stages in the evolution of this important social invention. Stage I is characterized by the application of the social insurance principle to relatively few risks and only to selected groups. There is either no government contribution, or at most a nominal or token contribution.

These characteristics reflect the function which social insurance was brought into being to perform and the prevailing social and economic environment. It was a period of expanding capitalism in which great emphasis was placed upon individual responsibility, coupled with a firm belief in the wide range of economic opportunities open to the individual. Hence there was broad social acceptance of the theory that poverty was a disgrace or a sign of incompetence. It was thus to the interest of society as a whole that loss of income should be provided for on a deterrent basis, and this policy worked and was acceptable because it was not too sharply contradicted by the facts of everyday experience. It was a period, too, in which men were still apprehensive about the use of government as an instrument for effectuating desired income redistributions or other social policies.

At this stage it was important, in view of prevailing social attitudes, to stress the analogy of social, to private, insurance. Using this analogy, the concern of those who feared lest assurance of income would weaken the spur to participation in production, could in large measure be set at rest. No harm was done in paying assured benefits to selected and limited groups, it was argued, because (a) beneficiaries had contributed and were as much entitled to benefits as if they had contributed to a private insurance scheme; (b) the groups were carefully selected and long eligibility periods would ensure that beneficiaries were those and only those whose past behavior had demonstrated the earnestness of their determination to participate in productive work; (c) the short duration of benefit (in the case of unemployment insurance) and the low level of the benefit was a practical safeguard against the temptation to malinger.

This stage of social insurance may be said to have lasted in this country from the introduction of workmen's compensation legislation, up to, and including, the passage of the Social Security Act, and in Great Britain, from 1911 to 1920. During this stage the problems attracting attention are in the main narrowly technical or actuarial. Problems of administration and procedures, methods of investment and management of funds, analysis of experience records and refinement of controls assume prime importance. Discussion of the extension of social

insurance to additional risks or groups is also found, but always from the same basic assumption of a program for those who might be described as good risks from the viewpoint of society and of the productive mechanism.

Stage II in the evolution of social insurance is marked by a growing but uneven extension of social insurance to cover not only new risks but more importantly, new population groups. Either explicitly or implicitly (as in our own old age and survivors insurance system) the systems begin to include a more substantial contribution from general tax revenues. The institution tends to be a hybrid, exhibiting some of the characteristics typically found earlier in stage I and later in stage III.

Stage II is, I suggest, the stage in which we now find ourselves in the United States. In Great Britain it has persisted from 1920 until the present time, although the appearance of the Beveridge Plan and the public reaction thereto indicates that Britain may be about to enter stage III.

Stage II is essentially a period of instability and transition and it has this character because social attitudes and prevailing opinions concerning the character of the economic environment are also in transition. The environmental change is in part due to closer familiarity with the prevalence of mass unemployment which, when millions of obviously self-reliant workers are unable to secure employment, challenges the assumption that those without income are by definition improvident. In part the change is due to a recognition of the fact that a rising general wage level does not automatically solve the problems associated with interruptions to income.

But in part the change is directly due to the influence of an operating social insurance program. Once such a program is in existence it exerts, as I have said, a dynamic influence. Workers come to realize that there is in existence a technique for assuring security which from their viewpoint is preferable to the older methods. There are demands for coverage from groups previously excluded. These demands are the harder to resist because there are no sharply defined categories in the population which precisely correspond to the groupings suggested by logical reasoning. In the last resort the drawing of the line must work with averages and give rise to individual anomalies, cases of apparent hardship, or charges of arbitrariness. The attempt to resist these demands for extensions of social insurance by modifications and liberalization of the alternative social security programs only increases the pressure to change the character of social insurance. Once public assistance payments become more adequate for maintenance, invidious comparisons are drawn between, e.g., benefits paid on a social insurance system toward the cost of which the worker directly contributes and public

assistance which is financed out of general taxation. This kind of comparison is often made in this country in regard to old age assistance and old age insurance and in the thirties was frequently made in Great Britain in regard to unemployment insurance and unemployment assistance.

The dynamic influence exerted by social insurance as a going concern is evident in yet another direction. The discovery is made that the bases of an individualistic and capitalistic society are not utterly destroyed by such an institution. Even more important men become accustomed to the idea of using the instrument of government to carry out policies desired by a substantial segment of the population, and this willingness to countenance an extension of governmental activity in the realm of economic security is strengthened by other environmental influences which are accustoming the population to extensions of governmental activities and controls in other fields.

It is not surprising that in this period new problems begin to appear in contemporary technical discussion. There is a growing recognition of the interrelationships of the different types of public aid, and problems of over-all co-ordination assume importance. Increasing attention is given to anomalous situations created by the differing or inconsistent social insurance treatment of groups whose situations appear to be identical—situations inevitable because an increasingly comprehensive program has developed on a piecemeal basis. There is a growing recognition that social insurance is one of several available mechanisms for dealing with the problem of loss or inadequacy of income, which, among other consequences, adds new complexity to discussions of actuarial soundness. For it becomes evident that actuarial soundness for any one insurance program may be obtained at the expense of the residual programs for those who are excluded from a carefully circumscribed and selective social insurance measure.

In this period, too, theoretical discussions of "the banking versus the insurance principle," and of "private versus social insurance" assume increasing importance: They are the intellectual manifestation of a growing awareness of the changing character of the institution called "social insurance."

The third stage of social insurance for convenience may be indicated as that which now prevails in New Zealand and into which, as I have said, Great Britain appears to be moving. It is marked firstly by universal or practically universal coverage: social insurance now becomes a scheme for citizen protection and not only for industrial wage earners. Secondly it is marked by the inclusion of all the more common risks to continuity and adequacy of basic income. I use both concepts deliberately for it is evident that with the introduction of children's

allowances, maternity payments, health insurance for medical care and even funeral benefits, the scope of social insurance has extended beyond that of income maintenance in the strict sense. Social insurance in this stage is characterized also by relatively heavy governmental contributions toward costs.

The accompanying social environment is one in which majority opinion holds the view that all citizens should be assured a certain minimum income so long as they are incapable of working through disability or economic dislocations or who should not work as a matter of social policy (e.g., mothers with young children). This prevailing acceptance of the doctrine of public assurance of minimum income is vital and is a necessary condition for the forms assumed by social insurance in stage III.

## II

The differing stages in the evolution of social insurance and in their accompanying environmental context change the types of questions with which students of economics and social insurance policies are concerned—and also the answers to these questions. I have already indicated in discussing stages I and II that differing problems assumed importance in the two periods. I can most clearly illustrate my thesis in regard to stage III by considering three problems which in one way or another have attracted attention during the years in which social insurance has been in operation. They are the basic objectives of the benefits paid, the relation of social insurance financing to other fiscal policies of government, and the appropriateness of the pay roll tax as an earmarked source of funds.

1. *The Basic Objective of the Benefits.* In the first stage of social insurance it was theoretically and practically possible to disregard the question of whether or not benefits would or should guarantee a minimum standard of subsistence or maintenance. It was theoretically a dead issue because in the early stages the emphasis was upon the private insurance analogy of social insurance. The relationship between benefits and contributions being stressed, it was inevitable that the benefit should be a purely arithmetically or, if you will, an actuarially determined product. We can see this in the benefit provisions of the original Social Security Act of 1935. Even had there been no wide geographical variations in money or real wages and standards of living, I suspect our initial social security act would still have provided for differential benefits based upon differential earnings. It was, significantly, not only the federal old age insurance program that contained this provision but also the state unemployment compensation programs.

Neglect of the whole question as to the relationship of benefits to the

costs of maintenance was also theoretically possible in the sense of being logically justifiable because in many cases the scope of the initial social insurance programs was restricted to certain carefully selected groups. These groups were in the main the higher paid or normally employed workers. Thus in Britain unemployment insurance was first restricted to trades which were relatively highly organized and which were, in the words of Mr. Churchill, "not decaying trades, they are not overstocked trades, they are not congested with a surplus or an insufficient supply of labour." Similarly in the United States the important old age and survivors' insurance and unemployment insurance programs exclude two typically low-paid groups who are characterized by a considerable amount of part-time work; namely, agricultural and domestic workers.

In these circumstances it was quite consistent to provide benefits which the authors of the British system described as "exiguous" and "narrowly cut" for it was reasonable to assume some prior savings on the part of the recipient which would serve to eke out his benefit. It could be held, in other words, that the function of the system was merely to supplement private savings for the contingency in question. The short period for which benefit was then payable served further to strengthen the consistency of the type of benefit provided, for it was reasonable to assume that the payment of a small sum supplementing private savings performed a real social function so long as the worker was not expected to possess savings on which he could draw indefinitely.

In the same way the limitation of social insurance under the Social Security Act to the relatively higher paid groups facilitated a quite logical retention of the doctrine of proportionality between benefits and wages with no questions asked as to adequacy for maintenance.

I said that the character of social insurance programs in their first period of development made it not only theoretically but also practically possible to avoid discussions of the adequacy of the benefits for maintenance. The importance of the practical considerations can be seen by observing the effects of changes in the coverage of social insurance programs, in the duration of unemployment insurance benefits, and in the historical situations which brought them about.

A general trend toward the expansion of coverage is evident in all countries which have embarked upon social insurance programs. In our own country the popularity of the social insurance type of protection has stimulated demands from groups still excluded for coverage under the plan. But the attempt to extend coverage to groups such as agricultural workers and domestic servants inevitably raises questions as to the adequacy of benefits payable. Retention of the automatic percentage-of-wages formula when applied to groups whose earnings are

notoriously low raises doubts as to the net social advantage to the group to whom coverage is to be extended. The question may, for example, be raised whether it is any kindness to an agricultural worker to collect taxes from his admittedly meager current earnings, in order to pay him at age sixty-five a benefit which is likely to be far less than adequate to provide a minimum subsistence. The question is particularly relevant when it is recalled that the low-paid worker who gets the lowest benefit from a percentage formula is also the worker who is least likely to possess any significant volume of private savings, so that it cannot even be argued that the social insurance benefit, though small, will fill in the gap between independence and resort to public assistance.

It was for this reason that the National Resources Planning Board's Security Report, in discussing extension of old age insurance and unemployment insurance to agricultural and domestic workers stated:

> The inclusion of workers in domestic, agricultural and other low-paid employments should, therefore, be considered in relation to their patterns of employment and the character and amount of their earnings, and the feasibility of devising a benefit formula which will yield them significant payments. Additional groups of employees should be covered as rapidly as it can be demonstrated that they will receive adequate or significant benefits from the system.[8]

It is also significant that the Wagner-Murray-Dingell bill, which proposes immediate extension of coverage of old age and survivors' insurance to include agricultural and domestic workers and the self-employed (many of whom are members of the low income groups) simultaneously recommends an increase in the present minimum benefit from $10 to $20 a month.

The influence of the extension of scope of social insurance programs upon the character of the benefit structure is also evident in Great Britain. The influence can most clearly be seen in the unemployment insurance program, where extension of the scope of the program after the coverage expansion of 1920 took the form of extensions of duration of benefit. Once it was decided, for a variety of reasons into which we need not enter here, to extend duration of the now more comprehensive program to twenty-six weeks and later, almost indefinitely, it became increasingly difficult to divorce considerations of adequacy from the determination of benefit levels. For, given the general wage level and the low wages of many groups covered by the system, it was patently impossible to argue that the average worker would, even at the end of six months, let alone at the end of one year or eighteen months of unemployment, still possess savings which it was the function of the social insurance program merely to supplement. The ensuing development was logical and indeed inevitable. Over the next ten years de-

[8] *Security, Work, and Relief Policies*, p. 516.

pendents' benefits were introduced and the basic benefit was raised so that by 1931 benefits approximated a maintenance level. It is true that the British government (other than the Labor government) always firmly denied that maintenance was the standard; it denies it even today, as witness the most important reservation of the government in regard to the Beveridge proposals. But the fact remains that benefits were in fact raised to this level and in public discussion and in parliamentary debates it was the inadequacy of the benefit for maintenance which was the powerful argument in favor of benefit changes.

The point I am making is that the growth of consideration of the adequacy of benefits for maintenance is both a logical and a practically inevitable concomitant of extensions of the scope of social insurance programs. A problem that could be ignored in stage I becomes a central issue in stage III.

2. *The Fiscal Aspects of Social Insurance.* The economic repercussions of the timing and amount of insurance payments, and the methods whereby the funds are collected and the timing of collections become of tremendous significance for the economy as a whole once social insurance enters or approaches stage III. So long as social insurance payments were meager in amount, and confined to a small segment of the population, their effect upon the economy as a whole could be disregarded; at any rate they were not so noticeable as to compel attention.

Current proposals as in the United States, Great Britain, and Canada and the program in New Zealand envisage expenditures (and the corresponding necessity to raise funds) which may ultimately run as high as 10 per cent or 12 per cent of total national income payments. The fiscal implications of programs of this magnitude become of vital public interest, especially in view of the increasing recognition given to fiscal policy as an element in full employment policies—itself, note, an important and relevant environmental change.

In the United States we are today in the midst of a controversy as to whether or not the originally planned stepping-up of social security taxes should be postponed, and the same issue arose in 1939. Opponents and proponents alike center their arguments around the supposed inflationary or deflationary effects of imposition of new taxation at a specific time. Indeed, we even find in some cases that extension of social security coverage is urged today on the ground that it is an easy and acceptable method of increasing taxation as part of an anti-inflation policy.

Similar considerations appear in discussions of the benefit side of the picture. In 1938-40 increased payments to the aged (or even a universal pension) were urged in some quarters on the ground that such payments would be a politically acceptable and very effective method of

increasing consumer spending. Today we find the case for extension and liberalization of unemployment insurance deriving considerable strength from the argument that assured payments to the unemployed in a period of serious economic readjustment will, by maintaining a minimum level of purchasing power, assist in stabilizing the economy as a whole.

Once stage III is fully entered into, these considerations are not difficult for the economist to handle. In a country which has accepted the idea of publicly-guaranteed minimum income for the entire population, when, if you like, this policy is regarded as a first charge upon annual appropriations, there is no risk to the objectives of the program in merging social insurance financing with the general budget. The question of borrowing or reserve accumulation versus pay-as-you-go policies can be subordinated to the broader economic and fiscal policies of government. There will be no fear that promised payments will not be honored even though the public household (including social insurance programs) may have operated at some time on a deficit.

But the situation is far otherwise in stages I and II. Earmarked funds and a close tie-up between taxes and benefits may then be psychologically necessary for two reasons: to afford what appears to be a guarantee of the rights of the contributors, and to serve as a continual reminder that those who benefit have "earned" their privilege by contributing. Furthermore, so long as the concept of the basic minimum guarantee is not generally accepted, a simultaneous extension of benefits and lowering of taxes, which purely fiscal considerations might at times suggest, weakens the *quid pro quo* status of a social insurance program, threatens its public acceptance, and hence the dynamic influence this social invention is likely to exert.

It is for this reason that I could conceive it would be quite consistent for an economist who took into account not only the purely economic repercussions of social insurance programs *but also the function these programs were brought into being to perform and the environment in which they were operating* to support a proposal to subordinate social insurance financing to general fiscal considerations in New Zealand or Great Britain, but oppose it in the United States at the present time.

3. *The Appropriateness of the Use of Pay Roll Taxes.* The emergence of stage III will also require a reconsideration of the particular types of taxes to be utilized for social insurance financing. This is especially true of the pay roll tax. One of the more evident stigmata of social insurance programs in the past has been the fact that the programs were financed in whole or in part by employer contributions or taxes.

The appropriateness of reliance on taxes of this type has always given

rise to uneasy discussion. Economists who have explored problems of incidence have reached differing conclusions but appear to be in agreement on one point; namely, that the effect of the tax varies considerably as between different industries. The feasibility of shifting varies with the degree of monopolization of the industry, the elasticity of demand for the product, relative significance of labor costs in total expenses of production and the degree of labor organization. From the social point of view, the effect of these taxes has been deplored by those who have reached the conclusion that in general the pay roll tax is shifted to workers, whether it be via lower wages or unemployment or through elimination of wage increases that would otherwise have occurred or through increased prices. Again, those who believe that so far as possible tax policy should be neutral in regard to the process of production itself have criticized the pay roll tax because, being imposed upon an item of cost, it may cause otherwise uneconomic shifts in methods of production: a substitution of labor by capital equipment due solely to the "artificially" increased price of labor.

A survey of the literature on this point suggests that faced with these real disadvantages of the pay roll tax, its defenders have been forced to fall back upon the following justifications for its continuance:

1. The argument of fiscal expediency. The pay roll tax is fiscally a very convenient and richly yielding source of revenue for a social insurance program. It provides a relatively steady source of income, which, once earmarked for this specific purpose, may, like the gasoline taxes used for road construction, become identified in the public mind with a particular program and thus in a sense be secure from appropriation for other purposes. Fiscally, also, the pay roll tax was convenient for it facilitated the use of the employer as a tax-collecting agent; when he is paying taxes himself he can simultaneously collect the employees' contribution and his joint liability provides certain controls on the correctness of tax payments. Finally, so long as the fiscal incidence of the pay roll tax is not widely understood, the simultaneous imposition of a tax on employers renders more acceptable the new tax policy introduced by social insurance; namely, the imposition of an income tax on all wage earners which is at best proportional rather than progressive and which has no personal allowances. Workers "do not feel so badly" about the new tax when it is explained that their employers too are contributing to a fund that is, after all, to benefit workers alone.

2. The brake-upon-extravagance argument. A second defense of use and retention of the pay roll tax builds upon the desirability of enlisting the interest of employers in the effective and economical administration

of the program. If they contribute they have a financial interest in guarding against extravagance or excessive liberalization and because they contribute they may rightly claim to have some say in administrative and policy determinations. It is this last argument, incidentally, which Beveridge finally falls back upon after having built up what to most readers would seem to be a convincing case against retention of the pay roll tax.

3. The argument of incentive taxation. The third defense of retention of the pay roll tax appeals to the potentialities of incentive taxation. So long as there is a pay roll tax it can be varied upwards or downwards in such a way as to reward or penalize employers for action tending to reduce or increase the prevalence of the risk insured against.

I suggest that the validity of these theoretical justifications of the pay roll tax cannot be evaluated without reference to which stage of social insurance evolution is under discussion. Thus the fiscal justification is powerful and necessary in stage I and perhaps also in stage II. But in stage III I suggest it has little validity. Once social insurance programs have become almost universal in coverage, every voter has a stake in the continuity of appropriations to make good the payments guaranteed. Indeed the very fact of universality of coverage is an indication of a change in social attitudes. For it is a response to a widespread desire for minimum security; social insurance has become the device through which society ensures that this new demand can make itself felt. The need for earmarked taxes as a bulwark against failures to appropriate adequate funds is no longer so necessary in view of the changed attitude.

Nor are the other fiscal justifications very strong in stage III. By the time this stage is reached workers will necessarily have become accustomed to the payment of taxes. Furthermore, as knowledge of the incidence of the employers' contribution becomes more widespread the strength of the argument that "employers too are contributing" is less convincing.

The brake-upon-extravagance theory retains some validity in stage III in the sense that a powerful lobby against undue liberalization is more likely to appear if the earmarked taxpayers are also relatively small groups with a strongly developed group consciousness. But it is also possible that concentration of the immediate impact of social insurance taxes upon a relatively small group may give that group a disproportional power to block liberalizations that are desired by the majority of the citizens. This consideration is especially important in a program of universal coverage: a country dependent on export trade may find itself unable to afford a certain level of social insurance bene-

fits when the cost of these is assessed against an item in costs of production although with a different method of financing the desired degree of income redistribution could have been attained.

Finally, retention of the pay roll tax for incentive taxation reasons can be urged only in certain limited fields at any stage of social insurance development. It obviously has no application in an old age and survivors' insurance program or in a general disability program. And even in regard to unemployment insurance its sphere of application is likely to be relatively restricted if it is to be limited to those types of unemployment, and these alone, which are in any real sense within the employer's control. It seems probable that the incentive tax theory alone cannot justify retention of the pay roll tax as a major source of revenue for a comprehensive social insurance program covering all citizens and a wide variety of risks.

## III

It is, I think, evident that in this country we are today in stage II. Whether we shall ever emerge into stage III I do not know. Obviously many of the developments which have carried other countries into stage III are already present. The demand for broadened coverage is strong; the extension of duration of unemployment insurance benefit is already under way; we are already contemplating the introduction of new risks such as disability; we have adopted dependents' benefits in our most important program and minimum benefits are now accepted in principle in all programs. Above all, with each year of the operation of social insurance programs, the country is becoming more familiar with the activities of government in this field.

On the other hand, the country as a whole is, I suspect, far from accepting the idea of public responsibility for assuring minimum income. Furthermore, the implementation of such a policy will meet tremendous technical difficulties in a country where standards of living and real wages are still so far from homogeneous. And the influence of the labor movement, which in other countries has been the dynamic agent forcing social insurance in the direction of stage III, is likely to be somewhat different. For organized labor in America holds a firm belief in industrial action, with high wage rates as the goal. It is somewhat suspicious of dependents' benefits, and above all insists on the reflection of higher earnings in higher benefits. If the country has to face a continuance of these differentials over and above any minimum maintenance benefit—more specifically if using a social insurance program even to assure a minimum of $20 a month means also using government programs to assure monthly benefits of $120 a month—the proposal to

raise minimums toward the maintenance level may meet strong resistance.

But so long as we are in stage II I believe that economists will have to recognize the impossibility of securing a neat and consistent social insurance program. Equally impossible will be a complete reconciliation of the objectives of our social insurance program with policies which are "economically desirable" in the sense of those contributing to a maximization of production. In these circumstances, therefore, while as economists we should at all times draw attention as honestly as possible to the economic implications of social insurance programs operating at any given moment, we must exercise restraint in inferring from this analysis that a specific course of action "ought" to be adopted.

In conclusion, I venture to suggest that in studying social inventions such as social insurance, we run the risk not only of spending our time on the discussion of irrelevant issues but also of drawing false conclusions as to what is desirable policy unless we recognize: (a) that the institution in question was brought into being—invented, if you will—to carry out a specific function; (b) that the operation of the institution can never be studied except in a specific social and economic environmental context, which must at all times be clearly stated as the premises from which the analysis proceeds; (c) that the prevailing relevant environment may change, and that the existence of the new institution itself may be instrumental in bringing about some of these changes; (d) that these environmental changes may change both the function to be performed and the techniques which are available for achieving the objective.

# WHAT TO EXPECT OF SOCIAL SECURITY

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Social security is today an immensely popular term. Everybody in public life is for social security and nearly all discussion of the subject concerns improvement and extension. It remains, however, a term of uncertain meaning, which conveys very different ideas to different people. To many Americans it means nothing more than old age pensions; to others, it is a socialized form of insurance protection against hazards whose normal consequences are poverty and dependency; to still others, a governmentally guaranteed minimum income in all contingencies of life; to others, again, an economic system which operates to afford plenty for everybody. These are only some of the concepts of social security widely prevalent in this country. This lack of precise meaning to some extent accounts for the popularity of social security. Social security is in fact more of an ideal than an institution or group of institutions. Yet if we are to intelligently discuss the place which social security should have in postwar America or how social security can be improved, we need to give an institutional content to the term.

What is called "social security" differs from country to country. Social security is a part of the total institutional pattern of the nations in which it exists and is most soundly conceived in conformity with such total patterns. It is something different in totalitarian countries like Germany and Japan from what it is in democratic countries like the United States and the nations of the British Commonwealth, and something else still in Soviet Russia. The existing governmental structure, the economic system which prevails, the stage of economic development attained, the history and traditions of the nation will all have their influence upon the social security institutions of the country and even upon what is considered to be social security. So will such social and economic factors as the state of family life, the economic position of women, the mobility of labor, the extent of union organization, and, above all, the nation's economic productivity. This holds true also for psychological factors such as the public attitude toward government, the degree to which security is valued as contrasted with the opportunities presented by risks, and the prevailing concepts of progress.

In this paper I shall use the term social security as it was defined in the report on *Approaches to Social Security*, published in 1942 by the International Labour Office. This includes within the term both social assistance and social insurance and also social security systems. Social security systems represent an integration of social insurance and social assistance. Social assistance stems from the old institution

of poor relief and "expresses the obligation of the community toward its needy members." It includes noncontributory pensions to the aged and to invalids (the American old age assistance and aid to the blind), mothers' pensions (officially called "aid to dependent children" in this country), unemployment assistance, medical assistance, rehabilitation of the disabled, and general public assistance (or relief). It is financed from general tax sources and is free to the beneficiaries. Social insurance, in contrast, "is situated between social assistance and commercial insurance." It is established by law and serves social purposes, but utilizes insurance principles. Today it includes workmen's compensation (which is known as industrial accident insurance in continental Europe), sickness (or health) insurance, old age, invalidity and survivors' insurance, and unemployment insurance (or compensation).

As thus defined, social security is broader than social insurance, although the latter term is sometimes applied to the entire scope of social security. It is narrower than the English social services and the Scandinavian social policy, which include, besides the social security institutions which have been enumerated, such other governmental services as public education, public health and medical services, public housing developments, minimum wage legislation, and still other publicly financed and directed programs for the benefit of people in low income groups. It is also narrower than economic security, which includes in addition to social security many other institutions whose objective is economic stability and an assurance of a satisfying minimum income for everybody.

As I conceive social security, it is oriented toward family and individual welfare rather than the functioning of the economic system. It is social in the sense that it is provided for by law and is compulsory in at least some of its aspects. It is usually administered by public officials and is always strictly controlled by the government. Its approach, however, is from the point of view of the welfare of the family and the individual rather than that of the nation as an entity or of society in the abstract. Its concern is with the immediate hazards confronting the family and the individual, or, rather, with their economic consequences, not with ultimate causes, as they appear to an economist.

Such a concept of social security is consistent with the totality of our existing institutions and calls for no revolutionary changes. Far from being inconsistent with our free enterprise system and our democratic government, it is a bulwark to these basic institutions, vitally necessary, under present conditions, for their preservation and continued successful functioning. Such a concept of socal security is also in accord with the past history of the development of social security in the United

States and, more specifically, with the statements regarding social security which were made by the President, the Congressional committees in charge of the legislation, and the Committee on Economic Security, which drafted the measure, at the time of the enactment of the Social Security Act.

In its present connotation, the term social security does not seem to go back further than 1933, when the late Dr. Abraham Epstein expanded his Association for Old Age Security into the Association for Social Security. It did not come into general use until the House Ways and Means Committee, in order to emphasize that the measure it recommended was not the Administration's Economic Security bill, changed its title to the Social Security Act. As a group of institutions, however, social security goes back to the earliest Colonial days. Social security in this country, as in England, had its beginnings in the Elizabethan Poor Law, which was brought here by the earliest settlers. Its subsequent development, however, was quite different.

England was far ahead of us in becoming industrialized. Economic conditions there were such as to bring home to public consciousness much earlier than here, that unemployment and poverty are not always the fault of the unemployed and the poor. England's racial unity and its unitary government facilitated earlier action and a more orderly development of social security than in the United States. This has often been noted, but it is less familiar that the differing history, concepts, and conditions also account for most of the differences in the present content of social security legislation in the two countries. We have never had a Poor Law Commission or a Beveridge Report in the United States, but on the other hand, England to this day does not have a workmen's compensation act developed on social insurance principles. The major social security legislation of England had its origin in dissatisfaction with the poor law but had the same objective of relieving distress. Social insurance developed as a substitute for poor relief, and retains many aspects to this day which plainly point to this origin. Completely absent in the development of social security in England has been the police power approach, which regards social insurance as a form of labor legislation, justified as a regulation of employment relations in the interests of the public welfare.

In contrast, social security in the United States has stemmed from labor legislation quite as much as from poor relief. Workmen's compensation developed as labor legislation, without even a realization at the time that it is social insurance. Unemployment compensation and health insurance were both first advocated as logical complements of workmen's compensation. For twenty years before the American Association for Social Security was organized, the American Association for Labor

Legislation championed social insurance measures and cited the police power as their legal justification. It was not until the great depression had set in that the point of view that unemployment insurance should serve primarily as a relief institution had any popularity in this country. No unemployment insurance law was enacted until that time, but the legislation we got was something between the British unemployment insurance and American workmen's compensation. Similarly, health insurance proposals in this country have departed far from European models.

The great depression furnished the impetus for the swift advances in social security which we made in the thirties. But it was less dissatisfaction with the disgraceful administration of poor relief than sheer need for financial assistance to the local and state governments which brought the national government into the social security picture. By this time, the national government again does not concern itself with relief in any manner, and our relief laws and their administration have reverted pretty much to their predepression status. In many other respects also the depression now seems to have produced far less change in relation to social security than appeared to be the case a few years ago. Social security is approved of by everybody and there is very general agreement that it should be expanded and "liberalized." But there is very little interest in social security and a great lack of understanding as to what it is all about. Particularly, there is almost no appreciation on the part of the prospective beneficiaries that social security involves costs as well as benefits, while to businessmen social security is nothing more than a matter of taxes. The word insurance in the terms social insurance, old age and survivors' insurance, and unemployment insurance is one of the reasons for the popularity of these institutions in this country where everybody has an insurance policy. However, confusion and doubt are now being created by the view that social insurance is not "insurance" at all. Americans generally still regard private enterprise, initiative, and thrift as the best assurance of security. Unlike the British and despite all the gibes about the WPA, they believe that work is the best cure for unemployment and that government should provide employment when private industry cannot do so. They distrust their government, and, particularly, the "Washington bureaucrats." Yet it is a certainty that if serious trouble develops they, almost as one man, will turn to their government to help them and it will be the national government to which they will turn.

These are the broad outlines of the present American concepts and attitudes in relation to social security. This is the foundation now available on which we can and must build. This is not a very secure founda-

tion—and not so much because our social security legislation is defective in content or poor in administration as a consequence of confused thinking about social security. This confusion is largely attributable to the absence of any precise concept of what the term means and of all popular understanding as to the values and limitations of the institutions which are described by this term.

It is the thesis of this paper that to improve this foundation it is essential, at the stage of the evolution of social security in which we now are in this country, that we give to this term the meaning the International Labour Office has adopted. Further, we need to make the American public understand that the objectives and values of social security are limited but very necessary for the preservation of our institutions and the welfare of all our people.

This requires giving social security a narrower meaning than "freedom from want." Freedom from want cannot be guaranteed through social security measures. The possibilities of providing even a minimum satisfying income to all people and in all contingencies of life depend first of all upon total production. At this time when we are producing so prodigiously for war purposes, it may appear that production does not constitute any limitation to the attainment of freedom from want. But it remains undetermined whether we can produce for purposes of peace as much as we are now producing for purposes of war. Personally, it is my view that full employment, as we now know it, is too costly to be a practical objective for peacetime, although I believe that we can and must organize our economy so that we will have a much greater production than we had prior to the war, and an ever increasing production. This is an essential for the attainment of freedom from want. Most economic goods and services are so ephemeral that production must be continuous; moreover, what is a minimum satisfying income and even freedom from want is variable and in a progressive society will ever rise. Social security cannot assure the high and rising level of production which is essential to the attainment of such an objective. It may even be organized in such a way as to hold back production. It is my belief that it can be made a factor promoting production. It cannot become a substitute for industry, initiative, and invention, or for the proper organization and controls of our economic system.

This does not mean that social security does not matter, nor that social security proposals should be judged primarily on the basis of their probable effects upon the functioning of the economic system. It is my view that the economic planners who look upon social security as one means for reshaping the economic system towards ends they deem desirable are a greater menace to the improvement of our social

security institutions than are the Townsendites—and, as I shall develop later, I do not underrate the still present dangers from that source. It is a perversion of the concept of social security to look upon it as being primarily designed for the control of the business cycle, to insure full employment, or to redistribute income and purchasing power. Its effects in these respects should be considered and discussed, but should not overshadow its major objective—the protection of the individual and the family against the immediate economic hazards confronting them. Economists, interested as they are in the functioning of the economic system as a whole, are prone to look upon this objective as secondary; and perhaps it is, but it surely is not unimportant. Without maintenance of individuals and families in all contingencies of life, the hope of fundamental remedies for economic ills is but illusory.

It is very certain also that the economic system will never function so as to render unnecessary any social security measures. There is want and suffering even at this time of abnormally great production. Full employment and maximum production do not keep people from growing old and do not guarantee that many old people will not be in want and from reasons which are not their fault. There is some unemployment even in wartime and everyone knows that, under the most favorable circumstances, there will be a much greater volume of unemployment in the transition period. Sickness and invalidity have little relation to employment conditions and industrial accidents actually increase with increases in employment. Regardless of the functioning of the economic system, many breadwinners will die young and when this happens their surviving small children usually will be in poverty; and we cannot afford to overlook the fact that the great majority of all our children, upon whom depends the future of our country, are in the homes of the poor. Finally, it needs to be said, lest we overlook it in this connection, that this war is not being fought to establish in this country the Nazi concept that those who cannot contribute to the security of the state and are a drain upon its resources deserve no consideration. The care given dependents is one measure of the civilization attained and we mean to continue as a civilized and Christian country.

Equally unsound is the view that social security is principally a tax problem. This appears to be the predominant view in Congress and may well produce even greater havoc in the future than it has already created. In part, at least, this view has developed because in the United States we had to label the employer and employee contributions to the social insurance funds as "pay roll taxes"—which has not been done in any other country. The attitude toward taxes in this country has always been antagonistic, with an almost complete failure to appreciate that in its entirety it is a two-way, not a one-way, process. Social

security is not, at least mainly, an additional cost to society, but an orderly redistribution of costs which the American people have to bear in any event. Even from the point of view of the government's expenditures alone, the costs of a well-conceived social security system will be offset to a very considerable extent by reduced relief and salvage costs.

It is equally, if not more, dangerous that the largest groups of prospective beneficiaries think of social security in terms of benefits only and that this has also been the attitude of most of its champions in the ranks of the academicians and social workers. This is again a typically American point of view. Our economic growth has been so great that we have not had to think very much about where the money is coming from. America is the land of plenty and there is widespread belief that we can do anything. This is so infectious that it is not unnatural that even people who thoroughly understand what costs are involved, generally are willing to take the chance of a possible financial breakdown in the future to get improvements now about whose costs they do not dare to talk. England, while it has something like "pay as you go" financing for old age insurance, provides for increasing government, employer, and employee contributions as disbursements increase with the lapse of the years. In contrast, when the Social Security Amendments were passed in 1939 no estimates of costs whatsoever were given Congress and language was written into the act which can be interpreted as implying that we should not look ahead more than five years. This has been followed, in three successive years, by the "freezing of social security taxes" (which is really a reduction in taxes already levied), although no one claims that the accruing costs do not far exceed the amounts collected from present taxes. Many of the people who understand what is happening still see nothing very alarming in these developments because they are confident that a future Congress will come to the rescue with large government contributions from general tax sources. Time may justify their hopes, but it is a fact that Congress to date has refused to make any such commitments, even in committee reports, and in 1939 struck from the original law the actual government contributions provided therein, in the form of a high interest rate on the reserve funds.

The greatest danger in this sort of an attitude lies not in the possibility that present commitments may not be fulfilled, but in amendments which will prove ruinous. The view that only benefits matter and that future costs can be ignored is an invitation to the increase of benefits beyond all present economic possibilities. It is not without significance that Dr. Townsend now uses "pay as you go" as one of his slogans. Because the old people are at this time more interested in

winning the war than in the mirage of $200 per month pensions, there is a general belief that all danger of runaway costs is past. It is a safe prediction, however, that should the end of the war be followed by the widespread loss of jobs by the older workers, a strong demand for something like the Townsend Plan will again arise. While the Townsend Plan will never become law, there is a decided possibility that ere long we may have a "Baby Townsend Plan"—and babies usually grow. As Elizabeth Brandeis has put it, in a still unpublished article: social security properly conceived is more of "a net to catch those that fall" than "an overly soft feather bed." But there is danger that it may be converted into an institution which "may demoralize not only workers, but statesmen, business leaders, and the public." As the Romans discovered long ago, "it is relatively easy to provide 'bread and circuses' for the populace," but once we adopt that type of social security there is no stopping point.

I view with similar concern the playing down of the "insurance" in social insurance, which has developed since the passage of the Social Security Act. It is understandable that insurance company executives and actuaries should look upon private insurance as the only kind of insurance meriting the esteem and confidence which Americans attach to that term. It is even clearer why certain politicians see political advantages in creating distrust of the government's handling of the social security funds. It would be extremely unfortunate, however, if they persuaded the workers that their funds were not safe with the government. Equally dangerous is any weakening of the contributory principle. The several forms of social insurance differ from private insurance, but not more so than do the several kinds of private insurance from each other. It is anomalous, to say the least, that the very people who justified reducing the pay roll tax rates by denouncing reserves as having no place in social insurance also were responsible for the provisions in the Social Security Act Amendments of 1939 limiting benefits to currently insured and fully insured persons. These are clearly concepts taken from private insurance, and they are likely to work out in such a way that many millions of war workers will get nothing at all for their social security deducations from pay rolls.

I also do not accept the view that social security is nothing more than a relief institution. I include social assistance within the concept of social security. But I object to making of social insurance but another form of relief. In the English environment and with the background of the history of social security in England, the concept that social insurance is a substitute for poor relief may be adequate. In the United States, where social security developed from labor legislation as well as from relief, there is still value in retaining something of the police

power approach, although it alone also is not adequate. It is a defeatist attitude to say that, because the hazards against whose consequences social insurance is designed to provide protection cannot be wholly prevented, no attempt should be made to utilize it for preventive purposes. Such a position is illogical and is bound to provoke much unnecessary opposition to proposals for the improvement of social security. It is also to be noted that the world over, social security is increasingly coming to mean not merely cash payments but also social services with a preventive objective.

This entire paper, I know, sounds like a jeremiad. It is not so intended. There are trends affecting social security that I view with alarm. I am particularly concerned because there is such hazy thinking about social security and what may properly be expected from it. But I do not despair of social security; and I have not lost my faith in social security.

We have made great progress toward social security under conditions none too favorable. Unlike most of the other Allied Nations we have made no legislative gains since the war began, but it is not unlikely that the end of the war will afford an opportunity for advances as great as those of the thirties.

Advances in social security have been made, above all else, because all peoples long for security in a world that in their own experience has been very insecure. The quest for social security is but one manifestation of a much broader phenomenon of the present day and age, which includes all of the "four freedoms" and beyond these a desire for a secure world, and for the security of life itself. In the midst of great insecurity, security has come to be valued, perhaps, even more than opportunity. The war has very greatly increased this longing, making "security for all" almost as attractive a slogan as was "making the world safe for democracy" in the last war. In this country this feeling has not to date had any important repercussion on social security. It is likely, however, to result in a much stronger demand than we now have for a better social security as the final victory comes in sight. That demand is likely to become well-nigh irresistible should the victory be followed by widespread unemployment and suffering during the period of military and economic demobilization.

The conditions and thinking produced by the war need to be taken into consideration in planning for postwar social security. But it must not be lost sight of that the United States will probably come through the war less changed than any other country. In the crucible of war we are developing a renewed faith in our democracy and our destiny. While taking account of the new, our future social security must be

built on our entire experiences, of which the present war is the most immediate, but by no means all that matters.

I have deliberately not discussed the specific proposals for postwar social security which are now before the country. Of these the Wagner-Murray-Dingell bill is by far the most important. There are many parts of this bill that I like and others that I do not like. Senator Wagner in introducing this measure said that he was offering it rather for purposes of discussion than with intent to have it enacted into law as written. I believe this bill to be timely and that it can be made excellently to serve its stated purpose. To this end it is to be hoped that there may be early hearings on this measure. I have elsewhere suggested the organization of another Advisory Committee on Social Security, which, this time, should be sponsored by both of the Congressional committees concerned with social security legislation.

In addition to consideration of the details of the social security needed in postwar America, there is an equally great need, at this time, for a clarification of thought as to what social security is and what can be expected of it. During the past two years, the leaders of both the Associations which have concerned themselves with the advancement of social security (John B. Andrews, of the American Association for Labor Legislation, and Abraham Epstein, of the Association for Social Security) have passed away. It is doubtful at the moment whether either of these Associations will be able to survive the passing of their founders, despite the very great need for an organization outside of the government for the improvement of social security. This fact makes it all the more important that we should all do what we can to advance the cause to which they devoted their lives.

## DISCUSSION

E. WIGHT BAKKE: The papers which have been presented are contributions of a high order to our thinking about social insurance. Our social insurance mechanisms have grown piecemeal, in response to various pressures and in line with several theories of individual, industrial, and governmental responsibility. It is a requirement of orderly progress that we try to fit contemporary activity in the field into a pattern of development and consider how present results are related to the conditions of the past and the objectives for the future.

I think you will agree that Mrs. Burns has laid upon us a legitimate responsibility if we are honestly to study such social inventions as social insurance—particularly if we attempt to suggest policy—to recognize (a) that the invention was made to perform a specific function, (b) that it operates within a specific socio-economic environment which must be defined as a premise from which analysis proceeds, (c) that the environment changes, in part under the impact of the institution itself, and (d) that these environmental changes may change both the function to be performed and the techniques which are used.

I would like to suggest also a further obligation (1) to recognize clearly what the basic, as contrasted to the immediate, need is which stimulated the invention or the techniques it supplants, and (2) to ask whether the development of the institution is consistent with meeting that basic need, and whether any modifications of the institution in response to immediate economic, social, or psychological factors are imperiling its more perfect adaptation to this need. For the basic need is more unchanging than its definition at any particular time—more unchanging than the institution devised in the light of this definition, or the social and economic environment which makes a particular form of the institution acceptable.

Let me illustrate what I mean. Mrs. Burns has indicated that social insurance was an invention designed for the purpose of effecting a significant break in the deterrent treatment of insecure workers. Mr. Witte says social insurance in this country was an elaboration of labor legislation designed to place enlarged responsibility on the employer for industrial hazards, against which protection was needed in the public interest. I agree that this was so. But back of these needs was and is a more basic one. Industrial society in self-protection has had to provide for the maintenance and conservation, if not the improvement, of its human resources. To guard against the deterioration of these resources some minimum of maintenance for citizens has had to be provided, and our form of economic society raises the problem sharply. It is characteristic of industrial and capitalistic society that the resources an individual can bring to maintenance for himself and his family bear a close relationship to his productive capacity as defined by the economic ways of the age. But there is no assurance that productive capacity and need will be equal, for the productive capacity of many is low and the productive capacity of most is interrupted periodically by the hazards of unemployment, illness, accident, old age, and the like. Some device to fill the gaps is needed. The deterrent treatment of poor relief was such a device, as was compensation for industrial acci-

dents. The former was unsatisfactory and the latter was incomplete, and an alternative in the form of social insurance was devised.

Now it is true, as Mrs. Burns has pointed out, that the growth and operation of social insurance itself helps to clarify the definition of and impress upon us the importance of this basic need. But it does not create the need; it was already there and inherent in the structure of our economic society. That organized society as well as the individual is the beneficiary and that the conservation of human resources is a national economic problem was ever true. Students of the institution should not have to await the popular recognition of such problems before evaluating the institution as a medium for meeting them.

I cannot agree, therefore, that it was theoretically possible during the first evolutionary stage to avoid consideration of adequacy of benefits. It was theoretically possible if we premised our discussions on the prevailing conception of the role of social insurance; that is, as a supplement to individual thrift or an enlargement of the employer's obligation. It was not theoretically possible if we premised our discussions on the basic need which was back of all social devices for securing the nation against economic distress and the deterioration of its human resources.

We had available to us information about distribution of income, the number of our people at or below a healthy standard of living, the nature and extent of hazards of industrial life. We could have raised, and some did raise, the theoretical question of the validity of a scheme of benefits geared to previous earnings which provided excellent insurance for those who needed it least.

What is the basic as contrasted with the immediate need? Is the institution developing so that it meets this basic need more adequately? Those are questions we must constantly ask, whatever details of the institution we are considering. Asking these questions is important for another reason suggested by Mrs. Burns. Social insurance is a dynamic institution affecting the environment within which it operates. A part of that environment is the expectancies and interests which the institution arouses. The initial forms growing out of an incomplete conception of the basic need to be met may arouse expectancies and interests which stand in the way of development to meet that need.

It was natural that we set up our initial forms of unemployment insurance by using the analogies of workmen's compensation, terminal wages, trade union out-of-work benefits, insurance, and banking. Those were devices we were familiar with. It was natural that we set up our initial form of old age benefits by using the analogy of deferred annuities. Fortunately in the latter case the inadequacy of the analogy was recognized before we had paid many benefits, and the revisions in 1939 went a long way toward putting social insurance against economic distress in old age on a basis permitting further modification in line with the basic need.

Not so with unemployment compensation. The analogy with workmen's compensation suggested the idea of experience rating so that employers would be stimulated to prevent unemployment as they had been stimulated to prevent accidents. The analogy with terminal wages suggested that benefit rights should be proportioned to services for and wages from particular employers. The analogy with thrift devices of insurance and banking suggested

the relation of benefits to wages so that whatever protection an individual got should be proportional to his ability to buy that protection.

These developments have raised expectancies on the part of employers and workers which stand in the way of setting benefits at an adequate maintenance level with due regard to the size of the family and regardless of the previous earnings of the worker involved. They make it difficult to continue paying benefits after very limited initial periods of unemployment.

We are making some progress in raising minimums, lengthening periods of benefit and even suggesting dependents' benefit. But these expectancies and interests still bind us and keep us at the threshold of stage III.

At a time when social insurance was new to us it is understandable that we premised our thinking on the prevailing conception of the role of social insurance characteristic of stage I. But the events of the past decade, including the event of the Social Security Act and its operations, have brought us face to face with a larger conception of the nature of the social economy and with the fact that community action is of equal importance with individual action in assuring its stability and progress. In no field is this more important than in that of the conservation and improvement of our human resources. It is time we began to evaluate social insurance in the light of its potential role as an instrument for this purpose, as well as an instrument for supplementing individual thrift and enlarging the employer's obligations to his workers.

EMERSON P. SCHMIDT: When President Wolfe asked me to discuss the two foregoing papers, he said that he invited me because he assumed that the U. S. Chamber of Commerce would take "a critical position with regard to social security plans and that is what we need in the discussion."

Actually, the Chamber has no official position on most of the issues raised in these papers and it has never opposed the principle of social security and the same is true of most businessmen. Within a fortnight, Eric A. Johnston, President of the Chamber, in opening a conference on social security called by the Chamber, said: "Social Security is here and here to stay; both democratic and totalitarian governments have it. Businessmen have a deep interest in the formulation of the program, its financing and administration."[1]

Again, he said that our system "involves change and hardships, it involves job and income losses. . . . Just as I believe in business insurance, so I believe that social insurance has a place in a dynamic, changeful system."

Ralph Bradford, the General Manager of the Chamber, in announcing a new periodical entitled, *American Economic Security*, said: "Recent trends have been toward underwriting some of the risks and uncertainties of life by group effort either through voluntary or compulsory methods."[2]

Thus, the notion that business is opposed to social security should be somewhat dispelled.

The objections to social security by businessmen relate not to the program as originally conceived—that is, as a protection of minimum standards—but, rather, to some modern tendencies which had their counterpart in ancient and

[1] "Social Security in America," addresses delivered at the National Conference on Social Security, Chamber of Commerce of the U.S.A., Jan., 1944.
[2] Issue of Jan., 1944, p. 1.

decadent Rome, under which the state became the provider for its citizens as Mr. Witte intimated. If social security is designed primarily to develop certain minimum floors against inevitable wage and income losses in a dynamic society, businessmen will support the program. If it means that the state will become more and more the provider and guardian of the people, businessmen will raise at least an eyebrow.

Eric Johnston, in his address, said:

> Those who think that social security should go much further than to protect minimum standards are, I believe, unconsciously imposing a responsibility upon the state which will drive it into authoritarian molds; if the state is to guarantee full employment and full income for all at all times it must have the authority to carry out that responsibility. This, to me, seems elemental.

Businessmen favor social security primarily but not wholly as a device for redistributing income *over time,* and not between groups except, of course, for the inevitable cases of the indigent and insofar as insurance constitutes a pooling of risks. Much of the apparent opposition to social security in America stems from the impression which businessmen have gained recently that one of the primary purposes of social security is to redistribute wealth and income, not according to the marginal productivity of various individuals or groups in society, but according to some vague principle of need which businessmen believe might some day be not unrelated to events at the election polls.

Mr. Witte's analysis appears to me realistic in that it is the kind of program which Americans in general and businessmen in particular will support, and without the co-operation of all substantial groups social security is not likely to be a success.

I am not impressed either with the logic or delineation of Mrs. Burns's three evolutionary stages. Mrs. Burns's analysis of future indicated policy under her stage III is, to me, a complete *non sequitur.* Even if we are moving into a stage of comprehensive universal citizen coverage of minimum standards, this, in no way, requires abandonment of traditional and proven methods of financing social security. Persons covered, but without wage credits, must of course have their benefits financed by receipts from something besides pay roll taxes.

If agricultural workers are too low paid to justify a pay roll tax, we should try to improve their mobility and thus correct the evil rather than to subsidize a whole industry in perpetuity.

She favors coverage of the family group but there are few such groups which do not have wage earners among them for the greater part of their existence. Under a well-rounded social security system, it would still be possible to finance a very high percentage of social security payments by means of pay roll taxation.

But this is not the most serious *non sequitur.* She argues that in stage III the use of incentive taxation will be of less importance. I think just the contrary is true. If, in time, we extend coverage to temporary and permanent disability and adopt some form of cash sickness and health insurance for non-occupational morbidity, does Mrs. Burns mean to imply that the importance of prevention will diminish? If so, then all this talk about preventive medicine has been a mirage! Surely a free society needs to harness all the incentives

available to reduce risks rather than to compensate them.

The most fundamental error in Mrs. Burns's implied and indicated policy goes still deeper. We have never collected more than about 5 billion dollars in taxes in prewar years. There is general agreement that we face a postwar national budget of around 20 billions apart from any added social security costs: a two-ocean navy, a two-million man army, losses on foreign rehabilitation, debt charges, veterans' bonuses and rehabilitation, etc. This added to 10 billion dollars for state and local government will require tax revenues of 30 billions before we get to any expanded social security period.

Mrs. Burns suggests 10 per cent to 12 per cent of national income for social security. In other words, 35 or 40 billion dollars, or from one-third to one-half of our recent prewar national income, will filter through government. Before we cavalierly abandon pay roll taxes, we had better take a second look at the philosophy expressed here today.

Mrs. Burns tells us that indicated policy would suggest a minimizing of pay roll taxes and a great reliance on general revenue. If so, this means heavy taxes on the incentive to start new businesses, on expansion, on the incentive to put men on the pay roll. A major shift away from pay roll taxes will constitute another nail in the coffin of private enterprise.

America has already passed its peak production relative to world production and relative to certain hitherto second rate powers. We are entering a new phase of world power politics. If people in social security propose unsound fiscal policies—policies which destroy the effectiveness of our economy—they must share responsibility for the nemesis which threatens as Mr. Witte has implied. Businessmen, who ought to be in a better position to know than academicians, do not put any credence in the mature economy or oversavings theses; they are perfectly aware that, given proper incentives, the drive of 2 million American employers will expand, will develop new products, new uses for raw materials, and whole new industries.

But if social security, in the light of the afore-mentioned national budget, is financed by general revenues, it will mean a serious damper upon incentives and the reward our society holds out to the risk-taker, the innovator, and the enterpriser. A free system is one under which free men show enterprise. But society has an equal obligation to brush aside the socially- and politically-created barriers to enterprise. Students of social security should not become spokesmen unwittingly for fiscal policies which accentuate wage and job losses. Otherwise they merely plug up the spigot and overlook the bunghole.

In this respect, the Wagner-Murray-Dingell bill is relatively favorable to economic expansion, while the proposals of the National Resources Planning Board are revolutionary because, if adopted, they will of necessity make the life of private enterprise markedly tougher and shorter. If social security is to be expanded, businessmen would be wise were they to embrace the fiscal aspects of the Wagner-Murray-Dingell bill with open arms and reject in no uncertain terms the philosophy of Mrs. Burns's paper and the proposals of the Board.

If Mrs. Burns's views gain substantial minority support, it is my view that this will not only postpone the objective of general citizenship coverage but, even more importantly, will reduce the American potential in world affairs.

# THE POSTWAR LEGAL AND ECONOMIC POSITION OF AMERICAN WOMEN

## THE EFFECT OF CONSTITUTIONAL EQUALITY ON WORKING WOMEN

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It seems very probable that by the time the war is ended American women will have constitutional equality, or at least that the amendment providing it will be in process of ratification by the states. Passage of the amendment, which reads, "Equality of rights under the law shall not be denied or abridged by the United States or by any State on account of sex," will be the culmination of women's long struggle for the removal of all legal disabilities. There were no women lawyers in this country until the latter half of the last century, and we did not know that the words of the Constitution guaranteeing "equal protection of the law" mean only such protection as the common law gives them. We found it out by being denied certain rights considered fundamental for men.

The principle of interpretation involved has been expressed as follows: "The interpretation of the Constitution of the United States is necessarily influenced by the fact that its provisions are framed in the language of the English Common Law and are to be read in the light of its history." This principle of interpretation is relied upon in construing statutes as well as the Constitution and by state courts as well as by federal courts. In applying it to many matters it was inevitable that it should have been used in determining the rights of women.

Blackstone enumerates the fundamental rights of men as follows: personal security, personal liberty of movement, enjoyment of property, the right to apply to the courts for redress of injury. All these rights were denied or curtailed in the case of women.

Distinctions between the rights of women under the Constitution and those of men have been made in upholding special labor laws for women.[1] For a time the Supreme Court took cognizance of the changed position of women sufficiently to hold unconstitutional, minimum wage laws applying to women alone. It was said in one opinion: "We cannot accept the doctrine that women of mature age, *sui juris*, require or may be subjected to restrictions upon their liberty of contract which could not lawfully be imposed in the case of men under similar circumstances." This case (*Adkins* v. *Children's Hospital*, 261 U.S. 525) was followed

[1] *Muller* v. *Oregon*, 208 U.S. 312; *Riley* v. *Massachusetts*, 232 U.S. 671; *Miller* v. *Wilson*, 236 U.S. 373; *Bosley* v. *McLoughlin*, 236 U.S. 385; *Radice* v. *People of State of New York*, 264 U.S. 292; *West Coast Hotel Company* v. *Parrish*, 300 U.S. 379.

by *Morehead* v. *U.S. ex rel Tipaldo*, 298 U.S. 587; but was overruled in *West Coast Hotel Company* v. *Parrish*. In these cases no express reference was made to the Common Law subservience of women, but it lingered in the legal thinking of some of the justices.

Opinion among liberal judges that the new position of women in politics and the business world should eradicate the traditional legal treatment of women, has not been strong enough, and amendment of the Constitution is the only practical remedy.

Nor has piecemeal legislation accomplished the purposes. Occasionally a legislature, after much persuasion and delay, obliterates an old discrimination, but almost as often a new discrimination is created or an old one revived.

Two circumstances help explain the present swing to the amendment: first, the wording of the amendment has been changed to remove any possible ambiguities as to states' rights; and secondly, the Darby Lumber case, decided February, 1941, in which for the first time in this country a maximum hour and a minimum wage law for general occupations and applicable to men as well as women, has been upheld by the highest court. This decision has created the opportunity of having protective laws for women without giving their employers the alternative of replacing them with men. Sincere friends of wage earning women have always professed that this was desirable.

So after the war, working women with the rest of us in all likelihood will have equal rights with men under the law. They will have to get along without any laws that apply to them and not to their brothers. Just to say these words sends a shiver down the spine of many worthy people, perhaps some in this audience. They are afraid the states will simply abolish their protective laws rather than have them apply to both sexes. And what will the poor women do then? I say to you, what are the poor women doing now? Nearly all the states have suspended their protective laws for the war emergency. And the women are getting along extremely well. They are holding hundreds of jobs that were formerly supposed to be unsuitable for them. They are belonging to unions. They are drawing excellent pay. And they are liking it. Most of them probably have no idea that they could be driven out of some of the best of these jobs by a few strokes of a few pens unless the Constitution is amended in time. In her annual report, the Secretary of Labor enumerates actions which should be taken promptly when the war ends to facilitate the return to "normal peacetime ways." One of these is: "Revocation of all permits for the work of women beyond eight hours and for the work of women in the graveyard shifts."

Working women are bound to have some hard bumps during the adjustment of peacetime. The question is, will they even then be better

off if there are no laws restricting them in their work which do not restrict men in the same way? In order to answer this question we are obliged to look at facts in past experience.

When I say that we must look at the facts of past experience you know, of course, that I cannot point to exact statistics as to how many women in such and such an industry were benefited and how many women in such and such an industry were harmed. This kind of fact-finding has been done for protective legislation only on a very small scale and it is extremely doubtful whether it can ever be done on a large scale, not only because of inaccuracy of records, but because of many factors which are statistically elusive.

The facts we must look at are of various kinds that have a bearing on the situation. These include the motives bringing about such legislation as well as its enforcement and effects.

The initial incentive was of course the deplorable situation of many women working in factories. Women and children were found to be working under conditions and for wages that shocked the sensibilities. The cry arose that laws should be passed to limit hours of work and regulate the conditions. Emphasis was placed on laws protecting women and children because they were the most badly exploited and also because the courts refused, with a few exceptions, to uphold laws applying to adult men on the ground that they interfered with men's fundamental right of free contract. But the socially minded men and women who advocated the laws for women and children had the additional motive of creating a stepping stone by which they could lead the courts to the sanctioning of such laws for all persons.

As we well know, all of these motives were justified at least in some degree. Factory hours were steadily reduced—with shocking exceptions in canneries. Working conditions were improved.

I have passed swiftly over the credit side of the slate because these things are more generally known and better understood than the other side.

The debit side is not at all susceptible to accurate bookkeeping. How can we know how many women would work at night if they were permitted to do so, or what jobs they have been obliged to accept in lieu of night work? People have made limited studies of how many women were dismissed after new laws were passed but how can we know how many were not hired that would have been hired? How can we know how many are kept from promotion by such laws or what new work was never opened to women because of them? We can only enumerate instances that come to light either accidentally or through research where women have been hurt by such laws. Many such cases are recounted in a *Bulletin* of the Women's Bureau, Number 65, entitled,

*The Effects of Labor Legislation on the Employment Opportunities of Women.* In this investigation it was at first proposed to examine pay roll records of states having special legislation for women and in states not having such legislation to determine whether changes in the proportions of women employed were parallel in the two types of states. This plan had to be abandoned because plant records did not separate pay rolls for men and women. The inquiry had to be made by means of interviews, supplemented by statistics, and of course was done mostly by sampling, not pretending to be a complete survey. It follows that most of the instances I shall give of harm done by laws should be multiplied, but it is hard to know by how much. The foreword states (page xviii) that the report itself must be read for conclusions and the impossibility of generalization is pointed out (page xix). Chapter II of the *Bulletin* is called, "The Investigation—The Problem Outlined—Method and Scope of Investigation—Conclusions." This chapter has been issued separately as *Bulletin Number 68* of the Women's Bureau, and I believe has had wider distribution than the complete report. However, I am inclined to agree with the foreword that conclusions can best be drawn by an examination of the entire record. This is absolutely necessary if we are to have any idea as to what words like few, slightly, occasionally, and chiefly really cover.

Here are some of the curtailments of opportunity listed: Twenty-eight of 60 firms (nearly 50 per cent) gave the law as the reason for not employing women overtime (page 80). In a few plants men were put in for overtime hours on women's work and in one plant there was an entire shift of men to do what would require overtime on women's occupations. In a paper box factory in Illinois which employed both men and women it was stated that because so many laws were being put through each year, interfering with the employment of women, it was the policy of the plant to "squeeze in men" wherever possible (page 86).

The investigator casts doubt on the validity of these statements and points out the inadvisability of taking employers' statements at their face value because of their various prejudices. It seems to me that it would be just as likely that employers would be slow to admit that they discharged women rather than employ them for shorter hours, so I report these statements with the others for what they are worth.

Part of the investigation described in the *Bulletin* was devoted to the so-called "long-hour industries." In this connection it was reported that if women were permitted to work longer hours there would be an increase in the number of jobs open to them in establishments employing men longer hours than the legal standards for women. These jobs involve in Massachusetts an estimated increase of around 500 in a

total of 10,000 women already employed (5 per cent). I have taken the liberty of omitting the word slight because to me the curtailment of the opportunities of 500 women does not seem slight (page 111). In one plant in California, men had been substituted on work formerly done by women because of the inability to use the women overtime. The plant employed about 500 men and 200 women (page 122).

The *Bulletin* also gives reports of interviews with 23 women as to the effect of the hour law of 1919 in Massachusetts on their wages. About half of them reported a decrease in earnings as the result.

The *Bulletin* also records some interesting facts about night work prohibitions in various states. In discussing the evening shift in a candy factory in Massachusetts it was stated: "From the women's point of view the evening shift offers occasion for short periods during hours when home cares and duties are at their least. . . . The chance to make the extra money without neglecting home duties, combined with the variety and companionship of a job with other workers, makes the evening shift an expedient that has been thoroughly appreciated" (page 133). It was found that over 5,000 women were employed on night shifts in Illinois and more than 5,000 in Ohio indicating that a corresponding number of women are kept out of work in similar states by night work prohibitions.

The discussion of women elevator operators affords some amusing reading. One group of employers said they did not employ women because the work was too heavy and the next group said they purposely gave the jobs to crippled and old men. Of course they were different employers and there may have been different elevators. However, the investigation of states where women were permitted to run elevators at certain hours forbidden in others showed that women did run elevators in those hours. The proportion of women to men working at such time in Ohio was 20 to 19 (page 253). In New York hotels the proportion was 11 to 137 (page 253). This seems to indicate that where women operators are prohibited by law 10 to 20 per cent of the men operating them hold jobs that would otherwise be held by women. What were the women doing instead? Perhaps they were scrubbing floors of office buildings. Perhaps they were washing dishes in restaurants. After all there are many things that are harder than running elevators.

The *Bulletin* also gives a number of interviews with women taxicab drivers which show that such work is liked by women and easier than some other jobs open to them (page 348). Nevertheless, taxicab driving has been prohibited for women in some states.

Lack of space prevents the inclusion of other cases. Dr. Elizabeth Faulkner Baker analyzed this same *Bulletin* in a paper for the American Academy of Political and Social Science in 1929. She estimated

that the facts revealed indicated that the occupational opportunities of approximately 60,000 women had been hurt by these laws. She points out that this is a small number compared to the 500,000 working women who were covered by the laws. As a trained economist, Dr. Baker is better able to interpret the investigation than a mere lawyer, but I did not understand from the *Bulletin* that all of this remaining 500,000 women were benefited. Over and over again the investigators state that the conditions studied existed for other reasons than legal. However that may be, 60,000 is a big number.

In addition to these cases discovered by the Women's Bureau investigation, some other instances of suffering under the protective laws have come to light from time to time. The story of the women in the printing trades in New York is well known. After being forbidden to work in 1913, they struggled for nine years to have a law passed exempting them for newspaper work. They were told that they should be willing to make the sacrifice for the sake of women in other callings that needed protection.

In July, 1938, when the minimum wage law in the District of Columbia was reinstated, Miss Mary Anderson, of the Women's Bureau, went on the air and appealed to the public to stop the wholesale dismissal of women which was resulting. She did not say how many were feeling the disadvantage of the law.

At the 1938 Congressional hearing, Miss Mollie Maloney, president of Bindery Women's Local No. 66, said that the so-called "welfare laws" for women only had set women in the bookbinding industry back fifty years. She said:

> Twenty-five years ago in almost every bindery in New York City the head executive was a woman, and many highly skilled and well paid mechanical jobs were held by women. That is all changed now. Through the working and operation of those so-called welfare laws for women, they can no longer advance to executive positions, as their proprietor knows that he cannot keep a woman an hour or two after work to finish a job, so he gives the job to her male competitor who is not hampered by these laws (page 109).

In addition to noting these isolated facts on the debit side of the slate, we should put down some of the motives behind the labor laws for women that have little or nothing to do with the welfare of the women involved and are even opposed to it.

The original reason for sustaining special labor legislation for women was that the physical well-being of women was an object of public interest and care in order to preserve the strength and vigor of the race—a part of the ancient doctrine that individual liberties belong only to men, that litigation and legislation in reference to women should treat them as some kind of property.

The worst motive behind the legislation has been that of certain men's labor unions which have deliberately and consciously fostered

protective legislation for women so as to keep them out of their particular trades. An outstanding example of this is found in the history of the International Molders Union told by Dr. Frank Stockton in a study published under the auspices of Johns Hopkins University in 1921. He reveals that the Molders Union pursued a regular policy of advocating special labor legislation for women as a means to discourage their competition.

The extent to which this motive in other unions has brought about restrictive legislation for women cannot be known. It is peculiarly hard to guard against as the unions always pay lip services to the other motive of protecting health and morals of women. And usually well-meaning people can be found to back up demands originating with the unions.

The renewed agitation for minimum wage laws for women came at a period of deep industrial depression. Women's wages were too low but unemployment was the terrible scourge of the time. Immigration had been checked and the next step seemed to be to drive women out of industry where they were "undercutting" men. At this point, many humanitarian people of both sexes advocated minimum wage laws for women with the avowed purpose of helping labor generally. The attorney general of Ohio in his brief for the Supreme Court in the Morehead case (1936) said "that the employment of women and minors at less wages than men would accept had resulted considerably in the replacement of men in industry by women and minors." Former Governor Nathan Miller stated the situation thus in his oral argument before the Court. He said that opposing counsel claimed there were too many women in industry and the less efficient should be sent home to raise children.

It was all part of the "doctrine of scarcity" then prevalent: too much labor available; eliminate some of it. But the case of women differed from that of farmers and manufacturers in that no steps were taken to recompense women for the loss of their jobs.

Allied to these motives for securing legislation are similar motives underlying to some extent its enforcement. Enforcement of special legislation for women has varied from zero to fair. I do not think the enforcement has ever been completely satisfactory to its proponents except in spots where other factors have made employers and employees really wish to comply with the law. The story even parallels in some places the story of the enforcement of liquor prohibition laws—financial trouble, inspection trouble, jury trouble, judge trouble. One result has been that officials have had to rely on complaints, and the complaints have sometimes come from men who wanted the jobs the women held.

Another item to be placed on the debit side of the slate is the

nuisance cost of labor regulations. Enforcement officials have found it necessary to have such laws contain various provisions about posting copies of the law, keeping accurate records of hours and pay, and maintaining strictly regular schedules. This puts just that much more in the scale against women which they must overbalance either by extra skill or lower wages.

With constitutional equality the adult working woman will be freed of some of her burdens. Laws sincerely designed for her protection by including men will take away that choice which the employer has always had of discharging her rather than comply. There can be no laws prohibiting her from following any particular calling and probably there will be none preventing night work. With wider opportunities she will be permitted to decide herself what work she can do with least hazard and inconvenience. Strong unions may still try to keep women out of particular trades, but these unions will not be able to call upon the police power of the state to reinforce them. Spinsters and grandmothers will not be led up as unwilling sacrifices for the supposed benefit of "potential mothers" or for the improvement of labor conditions generally. If constitutional equality is attained in time, women will not be forced to abandon the new fields they have discovered because of the war. And in time they may find an exit from the vicious circle of cheapness because of limited opportunity and limited opportunity because of cheapness.

Men do not dislike women as co-workers because they are women, but because of their cheapness. War work has proven that women are not cheap when opportunities are plentiful. Some labor organizations discovered even before the war that it was better to admit women to their membership than to fight their competition on the outside. As this tendency increases, cheapness will lessen. We know that the doctrine of scarcity was unsound, that American power to consume is at least as great as its power to produce. If prosperity is to follow peace, women will be needed to do their part and will be better able to do it if their opportunities are not limited by legislative restriction. The situation was summed up at a hearing on the amendment by Mr. James O'Donnell of the Baltimore Molders' Union. He deplored the general attitude of his union and expressed the opinion that the molders would do themselves more good by welcoming women to their union. He said:

> John and Mary are both here and must make the best of it. They should not spend time in building up imaginery lines against each other. While one half is weak the other half will suffer. The time for make-shift is past. Tackle the problem right. Demand a square deal for each other. Nothing less is sufficient. (Hearing on S.J. Res. 65—77th Congress, March 7th, 1938, Part 2, p. 180.)

All the rules of law that deprived women of their most fundamental

rights have been called "protective." The laws that deprived married women of every shred of property and turned them over as absolute slaves of their husbands were called "protective." And perhaps they were protective, at least in many instances. When women neither read nor wrote and stayed almost their entire lives in one spot, their property was perhaps safer under the control of the men in their families who had a little more education and a little more contact with the outside world, just as the property of children is safer in the hands of guardians. The abuses of guardians are the exceptions rather than the rule as perhaps the abuses of husbands were the exception rather than the rule. The fundamental wrong was that women were forced into the class with children. We see that now, and for a hundred years have been slowly changing it. When wives, like children, had to do what the head of the family told them, and had to give their earnings to him, it was a boon to women to have the law step in and say to these husbands, "See here! You can't make your wife work all day in a mine. You can only make her work under such and such conditions." But in a little later period, when women were exploited by their employers rather than by their husbands, the compelling sanction was weak bargaining power rather than law. The law was again called upon to relieve the situation, but the suitable remedy was really improvement of bargaining power. If legal regulation is persisted in, women are likely to pass from the condition of slavery to their husbands to that of slaves of the state. We have made great progress in getting women out of the class of children insofar as their relations to their husbands and property are concerned, but they are still there insofar as many labor laws are concerned, and they are still there in the thinking of many social workers and economists. For one thing, most available statistics are hopelessly mixed as between women and children. Sometimes the statistics pertaining to "women" include females from ten years up, and most of them include females from sixteen or eighteen years up, so that all deductions from them are unsure and confused. It would be interesting to know how many of the women who are actually in the "exploited" class have been working ever since they were children. If they had been protected before they were twenty-one—given a chance then for education and training—their bargaining power as adults would very likely be greater.

My training as a lawyer leads me to think of working women as individuals. Some of those I have known have been bright, some dull, but all with considerable common sense, able to manage their ordinary affairs better than I could manage them. Each one knows her wants and necessities better than anyone else does. I do not think working women should be treated as children any more than working men. But there

# THE POSTWAR ROLE OF AMERICAN WOMEN

*By* Mary Anderson
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I am glad that the American Economic Association recognizes the importance of giving attention at this time to the postwar role of women. My only regret is that I am unable to bring to the discussion the weight of extensive research that the Women's Bureau is about to initiate—as a result of special appropriation granted by Congress.

Even while the war is being waged—with the end not yet in sight—and even while thousands of women are still being recruited to take the place of men as workers on the home front, we hear on many sides the question: In the postwar period what will happen to all the women now employed? Even broader questions are being asked by our women both as individuals and as members of organizations: What will be the role of American women in the reconstruction period? What will be their status and their share in the peace program—on the national and international levels? Will they have greater opportunity to hold outstanding positions and to mold policies affecting the interests of women than in the past, than in the present war period?

These are challenging questions. They call for careful analysis of the many vital factors in the equation. Such action is necessary to guarantee a fair deal to women and a sound basis to our future economy and social order.

There are some would-be planners who have a quick and simple solution. "Women will return to the home," they say. A letter received at the Women's Bureau recently is a good illustration of this attitude. It came from a union man—a young man, too. In writing about his industry—one in which women have been employed for a long time and which is just being organized—he ended as follows: "Wishing you success in your work and hoping for the day when woman may relax and stay in her beloved kitchen, a loving wife to some man who is now fighting for his beloved country."

I can match this viewpoint with that of some economists and industrialists. Several weeks ago I heard a man who holds a key position in an extensive program concerned with future economic developments announce on a lecture platform that he was not worried about women workers in the postwar world. He said, somewhat facetiously, he thought they would quit their jobs and stay in the home.

Fortunately, other authorities concerned with the transition from a war to a peacetime economy take a more realistic approach. They see the value of studying the relation of women to the future labor market and industrial production, to the postwar social and economic order, to

national reconstruction and prosperity, and to a lasting peace.

Women themselves take such a stand through their organizations. You may remember the Women's Centennial Congress back in November, 1940. The theme of the Congress as representative of the women participants was: "To look backward over achievements won, look outward at discriminations still existing, look forward to the emphases imperative for the advancement of mankind." This expressed purpose for the future must be the keynote of women's postwar planning today.

Take the matter of women's postwar employment, a question in which I am vitally interested. Certainly, no one believes that women should be employed at the expense of ex-servicemen or be the cause of their selling apples on the street. But this belief does not preclude a program of analyzing the problems and probabilities as to women's future employment, for women are part of mankind. President Roosevelt in his message to the Congress in January stressed the right of every American citizen to a useful and remunerative job. This means not only men but women workers whose services and sacrifices are essential factors in winning the war, and who have equally vital roles to enact in winning the peace.

Since the role of women as wage earners is such an important part of my comprehensive subject I would like to add a few suggestions from my vantage point in the Women's Bureau.

We have the example of the last war to prove the need of present planning for future adjustment of women—if we are to keep history from repeating itself in bringing injustices and undue hardships to women. In World War I as in the present conflict womanpower became increasingly valuable. Much as today—though on a considerably less extensive scale—women stepped into the breaches. They took the place of men in munitions making and in essential civilian industries. They rendered efficient and indispensable service. Nevertheless, no sooner had hostilities ceased than a reaction against women workers set in. The Woman in Industry Service, which was set up as a war agency in the United States Department of Labor to promote the effective utilization of women and which later became the Women's Bureau, was unable to turn this tide of discrimination. Various public speakers as well as certain labor organizations (upheld in one case by the National War Labor Board of that period) took the stand that women who entered industry during the war should relinquish their jobs after the war—regardless of resulting hardships to women. The attitude was due largely to the fear that lower-paid women would be competitors to men.

With this background let us look into some of the facts and factors of women's employment in the coming postwar period.

Statistics have a significant story to tell of women in the labor force before, during, and after this war. In the spring of 1940 not only were there 11 million women actually in employment but an additional 2½ million in search of jobs—or a total of 13½ million women workers. Current estimates place the number of employed women at about 16 million, with a possible peak of 18 million by the end of the war. Such a figure would indicate an influx of about 4½ million new women workers into the labor market since the beginning of the emergency.

We can expect the flood tide of women in the labor force to recede rapidly with the coming of peace to possibly 15 million. The large number of young girls who have temporarily left school for war jobs will be drawn back into the educational system when workers become more plentiful than work. Some older women who during the labor shortage have sought or held on to employment from choice rather than necessity will retire, though there will probably be more women in their forties and fifties in the labor market than before the war. Large numbers of housewives who due to the exigencies of war have joined the wage-earning ranks will voluntarily and gladly give up their jobs—but not all. War casualties and postwar training of servicemen will impose serious breadwinning responsibilities on many of these so-called "duration" workers.

These are some of the ideas stressed by John D. Durand in an article in the December *International Labor Review.* Basing his estimate on historical trends he predicts that in a possible labor force of 59 million persons by 1950, women may number 16½ or 17 million. He declares that such a total would be very few more than might have been expected had there been no war. Thus should the war end in 1945, an estimated 15 million women having or wanting employment during the reconstruction period seems not an abnormal situation.

In regard to his estimates John Durand goes on to say:

> Such a supply of labor is a challenge to American industry and Government. If full employment can be attained by providing jobs for all who wish to work, rather than by discouraging the employment of women and trying to cut down the labor force, the expansion resulting from the war can mean greater prosperity than the Nation has ever known. To this end the need to provide jobs for a much larger number of women should be recognized in the plans which are now being laid to maintain employment in the postwar period.

The Woman's Bureau is in complete agreement with this idea. We know from our twenty-five years of study of women wage earners' problems that the vast majority of women workers seek employment from economic need.

Calm recital of facts and figures will scarcely allay rising fear in some quarters that women will take jobs from returning soldiers. Nor will statistical statements prevent unjust and unfounded discrimination

against women workers. Facing the special problems of women and formulating specific solutions must be the line of action. Otherwise, in the transition period of sudden demobilization of both military and industrial forces, with large numbers of jobless persons competing for work, women will be the victims of a catch-as-catch-can situation. Another complication looms, as a result of women's migration in the past two years from less to more essential jobs, from civilian to war industries: Many women, having burned their occupational bridges behind them, may try in vain to go back to their former fields unless given special assistance.

When out of work, women as a class are offered less of a helping hand by unemployment compensation than men are. Benefits are based on wages and in general women are on lower wage levels. To secure benefits women quite generally have extra hurdles to clear—due to marriage functions, or assumption of household obligations. Women who simply quit their jobs are considered as no longer members of the labor force; therefore not entitled to benefits. They must prove their intention if they expect to continue paid employment. An extended and improved social security system is necessary to cushion postwar unemployment, but such measures are only stopgaps.

Full employment of our productive resources—both human and material—is essential to save the country from a worse depression than the one that began in 1929. Fortunately, demobilization of both the armed and the labor forces promises to be more gradual than after World War I. Already some cutbacks in war materials and corresponding increases in civilian goods are being effected. Plans are under way to give further training and discharge pay to servicemen. There is some talk of a dismissal wage for munitions workers. The future employment of millions of men is now being given expert attention by leaders in industry, labor, and government. Nevertheless, except in rare instances, women's role in peacetime employment is being overlooked or underestimated. Full employment means women as well as men. Readjustment and re-employment of men *and* women must be worked out.

A policy to be woven into the whole picture is the equal-pay standard for women. To evaluate women's services on a cheaper basis than men's or to permit women to compete with men as workers on lower wage levels is neither sound nor just. I prefer to state the equal-pay policy in a somewhat different way—in the terms advocated by the Women's Bureau from its beginning—that wage rates should be based on occupation and not on sex. During the war considerable progress towards this goal has been achieved through the efforts of government, labor, and industry. But much greater gains must be made to keep the double wage standard from undermining our postwar employment program and economy.

Then take the matter of wartime training—another significant feature in labor adjustments after the war. As never before, women have acquired through vocational courses and in-plant instruction new mechanical skills, which will be invaluable to reconverted industries. Perhaps an even more influential factor in postwar readjustments is the training that has been given large numbers of men in the Army and Navy, along many technical lines, which some of the men may prefer to follow in peacetime rather than to return to their prewar pursuits. A former machine operator may choose to continue as an aviator, a bank teller as a radar expert, a railroad information clerk as a transportation specialist, and women who during the war stepped into the gaps in many fields may be retained after the war.

Full employment is not just a fantastic dream if plans for reconstruction equal to war blueprints can be formulated and carried out with similar urgency and speed. Why not? For us again to limit production as we did in our prewar economy would be nothing short of disastrous. It has been estimated that in 1929 our productive resources were used to only 81 per cent of their capacity, and in the years immediately following to less than 50 per cent; that 100 million man years of labor in this country were wasted through unemployment; that this waste caused the loss of 200 billion dollars' worth of potential goods and services—or the equivalent of a $6,000 house for every family in the country, or enough to build the railroad system of the nation five times over.

Full employment seems a real possibility when we hear economists stress the essential and rapid expansion of all kinds of consumer goods manufacture on a scale never before conceived to replenish depleted stocks the world over—especially in view of the international programs of relief, rehabilitation, and nutrition already launched. By way of illustration are the U. S. Chamber of Commerce forecasts on postwar demands for almost 3½ billion dollars' worth of automobiles for 3,675,000 families, over 1½ million new homes valued at nearly 7¼ billion dollars, over a billion dollars' worth of such appliances as refrigerators, kitchen mixers, and so on.

It takes no stretch of the imagination to foresee extensive employment of women in this industrial expansion. Women have for years constituted large proportions of the work force in the service industries and in textiles, clothing, food, and other types of consumer goods, and will probably hold their own or even advance in the years ahead.

The electrical industry looms as a veritable promised land for women, in view of the large number in this field before the greater number added during the war, in conjunction with the future development of the industry that is sure to be stimulated by electronics, television, and so on. Then the near-magic realm of plastics, with its war mushroom growth,

offers peacetime prospects of miraculous new products, exciting expansions, and employment opportunities for women.

Though aircraft manufacture will undoubtedly be scaled down from its war peak, we have reason to believe—what with global aviation forecasts—that it will remain in the big-industry class. Surely women will be given a chance to apply their skills, after their amazing record—some 4,000 women in airplane production a week before Pearl Harbor, 360,000 so employed two years later.

Even in the more strikingly masculine strongholds such as machine-tool plants and automobile factories there may well be a place in the future for the most competent women of the war period, who have even surpassed men at certain processes. There seems less likelihood that women will be retained to any real extent in steel mills or shipyards.

Concerning factory office jobs opening up to women because of the war, the general office manager of a large industrial corporation has this to say: "We believe there will be plenty of room for them (women) even after the men are discharged from the services. Quite possibly we shall be happy, later on, that during the war we did develop woman-power in our offices."

As plants reconvert and eventually swing into spectacular peacetime strides, they may continue to have a place for some of the professional women who have gained war footholds as draftsmen, chemists, technicians, engineering aides in industrial laboratories.

In general the unusual wartime opportunities that have opened up to professional women in their chosen fields will not shut down in the future. It seems safe to predict that many women who have performed with outstanding success will be retained in spite of male competition. The success of such women will create a growing demand for others in the new economy which we hope to achieve. Moreover, I believe a much larger number of highly trained and competent women will have leading roles on the national and international stage. The number has been deplorably small to date.

All this suggested participation by women in the winning of the peace cannot be achieved by optimistic prediction, wishful thinking, or faith without works. Therefore the Women's Bureau is not only giving specific study to possible postwar developments for women workers but is urging women's organizations to assume a share in educational efforts along these lines. Such organizations—national and international—are already giving thought to these matters. But they should see to it that qualified women are included on the various planning committees—whether set up by industry, labor, or government, whether on the local, national, or international level.

Women's responsibilities as American citizens in the postwar period

go much farther as many women are keenly aware. Last October women leaders from big national and international organizations met in New York City, called together by Anne O'Hare McCormick, of the New York *Times*, to discuss problems of war and peace and to map plans for a better world. This past week I took part in a somewhat similar panel discussion in New York on women's postwar economic status.

On neither occasion did the women participants take a narrowly feminist view. Instead they approached the discussion on a broad humanitarian basis. The vital and traditional role of women in the home and the valuable services they have to render in the community were not overlooked or minimized in the clarion call urging them to take a greater share in national and world affairs—both now and after the war.

Mrs. McCormick posed some very pointed and pertinent questions. "What's the matter with us that women's tasks are turned over to men?" she asked. "What have women citizens done or failed to do that they are not even thought of when positions of high responsibility are assigned? Is their world going to be reorganized without their counsel? Why aren't women in charge of food rationing? Why aren't they on official planning boards? Why aren't they called into the administration of relief and rehabilitation?" She charged too many women with being mere passengers, content to let others struggle and die to haul us through the storm into the port of safety.

These questions are signposts showing women the roles they must play and the roads they must travel both in the throes of war and with the coming of peace.

Women deserve credit for their achievements as organized groups in improving community conditions, getting better laws passed in many instances, rendering valuable service in all emergencies. But women have barely begun to use their powers as American citizens. We have in this country many able and well-trained women who could and should serve in state legislatures and the Congress of the United States, as well as in government positions on the policy-making level. Certainly a number of women—not because they are women but because they are qualified for the roles—should take their place side by side with men in the international organizations now existing or growing out of the war—the international labor organization, the organizations for relief, rehabilitation, and nutrition, the conference that will be called to make the peace, the organization that will be set up to preserve world peace and to promote security of nations and their populations.

Women cannot afford not to be represented fully in all these movements. Women have certain peculiar contributions to make somewhat different from those of men. Women are even more vitally concerned with the welfare of individuals and families, with protecting the weak,

healing the hurt, helping the needy, with settling difficulties in the field of human relations.

The challenge to American women is greater than ever before—to become better citizens in our own democracy and better citizens in the world. Many women are already aware of and ready to meet this challenge. I believe they will do their part—if given the chance—to help make this world worth all the blood and grief being paid today as the price for a free tomorrow.

# POSTWAR DOMESTIC MONETARY PROBLEMS

## PROBLEMS OF OUR DOMESTIC MONEY AND BANKING SYSTEM

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This paper is primarily concerned with the significance of certain economic changes which directly or indirectly have affected American banking. While some of these changes have been in progress for many years, others date from, and all were greatly accentuated by, the developments of the depression years and the period of war financing. My subject relates chiefly, therefore, to the effects of changes that have taken place during the last dozen years and especially during the last two or three years. Moreover, I am interpreting the word problems to include not only such questions of private and public policy and procedure as are the immediate concern of bankers and supervisory authorities, but also those questions of banking and monetary theory that are, I take it, the primary interest and concern of economists.

The discussion falls into three major divisions. The first will summarize the recent changes in American commercial banking and is designed to furnish a factual background for the subsequent analysis. The second section will deal with the manner in which these developments have affected the validity, and more especially the relevance to conditions as they now exist in this country, of certain theoretical conceptions concerning the nature and operation of commercial banking. The third section is concerned chiefly with the present and prospective outlook for commercial banking as a functioning organization.

### I

The most familiar of the changes in banking in this country relates to the nature of their operations. The general outlines of this change is reflected in balance sheet and income statistics which show the extent of the transformation of banks from holders of private to holders of federal debt. By the middle of 1943 the total of loans and discounts—only a relatively small proportion of which were commercial in character—were less than half the total of investments. All but a small fraction of these investments consisted of United States Treasury obligations. The change from a loan-and-discount to an investment type of banking was not a new development, even though the magnitude and rapidity of the shift in recent years were exceptional. As early as 1934 the volume of investments had come to exceed the volume of loans and discounts. It was not, however, until the first half of 1943, with the

dollar value of investments approximately double the dollar value of loans and discounts, that the income from investments surpassed the income from loans and discounts. While, asset-wise, banking could be said to have become predominantly investment banking by 1934, it was still, as judged by income, based principally on loans and discounts until 1943.

Along with a decline in the relative importance of loans extended by banks has gone a material alteration in their character. At one time it was customary to think of bank loans—not altogether accurately, perhaps—as commercial loans. In recent years they have come to comprise substantial amounts of collateral, real estate, term, and personal loans. They have very largely ceased to be commercial in origin or self-liquidating in character. In addition, income from services, particularly in the form of service charges on checking accounts, has come to play an appreciable part in bank earnings. This reflects not so much a change in the functions performed by banks as in the method whereby those functions are accomplished.

A second major change in banking has been the emergence on a large scale of excess reserves, and their continuance year after year despite strong measures to reduce them. While excess reserves have existed for short periods in the past, notably following the establishment of the Federal Reserve System, this constitutes a distinct departure from generally accepted banking tradition. In his *Treatise on Money,* Mr. Keynes laid it down as a fact, demonstrable by both reason and experience, that "banks use their reserves up to the hilt . . . [and] seldom or never maintain idle reserves. . . . Indeed, why should they?"[1] In support of this conclusion, Keynes argued that to allow reserves to fall below the accepted figure would reflect discredit on the bank (suggesting "weakness or weakmindedness"), while to allow it to rise above would be to forego unnecessarily a source of profit. He admitted that this reasoning assumed the availability of liquid income-yielding assets, but concluded that in England and the United States this condition was certain to be met.[2]

These views were presented in 1930. It is one of the minor ironies of the history of economic doctrines that beginning almost immediately thereafter events in the United States have continuously and completely contradicted Mr. Keynes's assertions. Since 1932 there has been no tendency for the reserves of member banks to be fully utilized; excess reserves have risen into the billions; reserve requirements have been greatly increased; and economy in the use of reserves at times ceased to exert any observable influence as a desirable banking objective.

[1] *A Treatise on Money* (Harcourt Brace and Co.), Vol. II, p. 53.
[2] *Ibid.,* p. 54.

A third group of banking changes involves alterations that have taken place in institutional and environmental factors. Among the major institutional changes were the establishment of the Federal Deposit Insurance Corporation; the adoption by the Federal Reserve Banks of an active policy with respect, first, to the government bond market and, secondly, to the pattern of interest rates; and the extension of Treasury activities in the direction of fiscal policies to combat depression, the direct purveying of credit and large-scale financial operations growing out of the war.

A further environmental change consists of a substantial alteration in the credit status of business. It was once customary to think of nonfinancial business enterprise as dependent upon the borrowing of working capital from banks. The most recent phase of the development away from financing through banks dates largely from the start of heavy war financing, and marks the emergence of nonfinancial business enterprises as large-scale lenders. Most of this lending has been in the form of the purchase of Treasury obligations, including tax notes, bills, certificates, and bonds. For the most part these are the same types of obligations that now loom so large in bank portfolios. The growth in this class of business assets signifies an extraordinary increase in the liquidity of business enterprises. It also means that what was once regarded as the most important customer of banks has come to share with them, on a significant scale, the field of lending operations.

These are by no means all the important changes that have affected commercial banks in the last ten or twelve years, but they are surely among the most significant. What I have to say concerning problems of theory and policy relates primarily to these three developments: the change in the character of banking assets, the emergence of large excess reserves as a continuing phenomenon, and the altered institutional and business setting in which banks operate.

## II

Despite the changes that have taken place, the mechanics of banking operations are essentially similar to what they were in the past. The process, whereby deposits are created—and may conceivably be destroyed—on the basis of fractional reserves and against changes in the volume of debts held by banks, is still fundamentally the same. What has changed is not the mechanics of commercial banking but the foundation upon which the mechanism functions; namely, government debt in place of loans and discounts. This change in basis is sufficient in itself to alter both the manner in which the banking system functions and the results that flow from it.

The changed basis of deposit creation has removed the last vestiges

of a regulatory mechanism directed toward, or capable of, automatically adjusting the supply of circulating medium to changes in the volume of transactions. The former conception of such a system[3] was greatly impaired first by the stultification and then by the disappearance of the framework of an international gold standard. As long as commercial paper constituted a substantial part of bank portfolios, an important element of an automatic system still remained. The underlying idea was that an expansion in the volume of trade would result in an increase in commercial paper and more commercial paper would lead to more discounting at banks, thus creating additional deposits. The elements of this theory were that banks were assumed to play a passive role, the initiative in the extension of bank credit presumably resting with business borrowers; deposit creation was supposedly noninflationary, the increase in circulating medium being paired against an increase in the volume of transactions; and the process was automatic. This theoretical model was highly idealized, but nevertheless it had a rational basis. No such basis any longer remains for supposing that banks are necessarily passive with respect to the volume of credit they extend, or that the volume of bank deposits is appropriately elastic as regards the volume of trade. In proportion as the logical ground for subscribing to a theory of the automatic regulation of currency and bank credit has weakened, the case has been strengthened for administrative control—by monetary management, central bank policy, fiscal policy or what not—if reasonable objectives of monetary policy arc to be approached.

Growth in the volume of federal debt outstanding has been determined, in the present century at least, primarily by two factors, war and depression. The volume of federal debt, in contrast with the volume of commercial paper or of bank loans, has shown the following characteristics: it increased greatly in time of war and business depression; it decreased during the period of prosperity in the twenties; it showed fewer and smaller fluctuations in relative amount. The inference is clear that a deposit structure tied primarily to government debt, if this proves to be the case, will behave differently from one tied primarily to business, or to business and personal, debt. It will probably show a greater stability as to amount, and instead of contracting at a time of business decline it may exhibit the opposite tendency.

A decrease in the volume of Treasury obligations held by banks could chiefly come about through a net repayment of debt by the government or a transfer of federal obligations from the banks to other investors. The probability of either of these possibilities taking place on a large scale in the near future does not appear great. A decline in business activity will not automatically reduce the volume of federal debt held

[3] As presented, for example, in Gustav Cassel, *Theory of Social Economy,* Sec. 46.

by banks, and it is questionable whether a worsening in the psychological climate is likely to produce as great a decrease in total earning assets as was typical in the past. As a consequence, the volume of deposits is no longer subject to the same spontaneous process of contraction in a period of falling business. This is a fact of very considerable importance, its precise implications largely depending upon the significance attached to quantitative changes in the volume of circulating medium.

Similar considerations apply with respect to conditions of business expansion. While the ideal of automatic elasticity in the volume of bank deposits was always something of a mirage, the clear-cut displacement of private debt by government debt as the principal basis of demand deposits has dispelled even the mirage.

To suggest that the volume of demand deposits is likely to be more stable as a result of the change in character of bank assets does not dispose of the problem of deposit contraction as it presents itself to the individual banker. For him it is a matter not so much of the total as of the redistribution of bank deposits. He is concerned as to the possibility of a flow of funds from one part of the system to another. At one stage of war financing there was a heavy movement of deposits from New York and certain other centers to banks in defense areas where heavy federal disbursements were being made. Banks that have experienced the greatest relative rise in deposits are, because of that very fact, confronted by the fear that later the movement of funds may be reversed.

The change in bank portfolios is important to the question of regional or local shifts in deposits even though the movement of banking funds within the banking system is determined by internal balances of payments and not by the type of security on which deposits are based. If at some future time public and private disbursements in the defense areas should fall below the payments these areas are called upon to make outside, a decline in their deposits and a drain of reserves to other parts of the country could be expected to ensue. Even though total deposits did not decline, it would be entirely possible for many individual banks to undergo a serious contraction of deposits. Nevertheless the strain would be less than it would if, as happened in the early thirties, the total volume of deposits was also declining sharply. And the strain on the system as a whole would be far less, for a condition of stringency in one area arising out of a decline of bank deposits in that area would have as its counterpart an expansion of deposits elsewhere. The strain would be easier to cope with simply because it was less general. In addition, banks in some areas would be in a position, because of expanding balances, to come to the aid of banks in areas losing deposits.

Our experience has repeatedly been that the amelioration of one phase of the banking problem has been followed by the emergence of a new phase. This may happen again; but it would seem that the bases of some of our banking difficulties of the past have been removed. Former difficulties arising out of the instability in the total volume of bank credit cannot be regarded as inevitably bound to repeat themselves.

The rise of a large and fluctuating volume of excess reserves is significant primarily because the assumption of a fixed reserve ratio underlies, to an extent that has not, I believe, received sufficient emphasis, the entire theory of commercial banking. The conventional description of the process of deposit expansion—with reserves overflowing from Bank 1 to Bank 2 and so on up to Bank 10, thereby generating a neatly descending series of deposit growth all along the line—rests on the assumption that reserves will be fully and promptly utilized. So also does the belief that banks are compelled by the nature of the banking process to move in step with one another, so that it is impossible for a bank to expand or contract deposits other than at approximately the same rate as other banks in the system.

Studies made by the Federal Reserve authorities at the time of contemplated increases in reserve requirements in 1937 and 1941 disclosed wide differences in the volume of excess reserves held by member banks. These differences were a rough measure of the failure of the assumption to hold true that banks move in close harmony in the matter of credit creation. Under such conditions the effect of bank reserves in bringing about similarity of policies among banks is probably exaggerated. On the other hand, there may have been too little recognition of the uniformity that results from a desire to avoid an appearance of unorthodox behavior that might have an unsettling effect upon the minds of their customers—and doubtless, also, upon their own.

In Great Britain there has been no such departure from customary reserve ratios as has occurred here. There has been nothing to correspond to the growth of large excess reserves in the United States. Credit adjustments in England are far from automatic in the sense that was once assumed, since the Bank of England under war conditions has been as ready as the Reserve Banks to create whatever reserves might seem to be called for to facilitate war financing. But the presumption of a fairly constant ratio of reserves to deposits and the reasoning on which that presumption rests have not been seriously challenged.

As a result of this divergence of experience in Great Britain and the United States, one of the bases of current banking thought has lost its validity in this country while retaining it, to all intents and purposes, in England. The difference in the applicability of banking theory in the two countries would be less significant if banking thought in the United

States were truly indigenous or independent. In point of fact, it is neither: advanced thinking in this field is, and long has been, largely dominated by the writings of British economists. Among the leading theorists in the field of banking today the names of Hawtrey, Robertson, Keynes, Sayers, Durbin, and Whale are outstanding. All of these men are British and collectively their ideas exert great force in this country.

As long as the conditions under which banking was carried on in the United States were fairly similar to what they were in Great Britain there was no strong reason to find fault with this situation of tutelage to British thinking in this field. With the disparity in conditions there and here the matter becomes more important. It signifies that prevailing theory has partially lost contact with facts in this country. In addition, a barrier has been thrown up which interferes with an accurate understanding of one another's ideas and may render agreement on policies more difficult. A part of the disagreement over the Keynes and White monetary proposals was probably attributable to reciprocal lack of familiarity with banking practices in the two countries. This lack was the more serious because it was by no means generally realized.

The change in character of bank assets signifies a shift in the economic functions performed by banks. At one time it was customary to regard banks as directly facilitating the production of goods and services. As referees of uses and users of credit, they were part of the machinery for allocating scarce means among competing ends. Furthermore, as dealers in debts they exchanged their own highly regarded credit for the less widely known credit of their customers. In both respects the situation is now very different. As holders of government obligations the credit operations of banks are only indirectly related to the productive process. And in acquiring obligations of the government in exchange for their own, banks can hardly be said to provide credit of a higher quality than that which they receive.

Thus the economic functions that were generally regarded as of primary importance in entitling them to a share in the income of society have for the most part disappeared. What chiefly remains is the business of serving as the center of a clearing organization engaged in transferring and canceling checks. This is doubtless a highly useful undertaking but the question may be asked, as it has been in England, whether so elaborate an establishment, enjoying so unique a privilege as that of creating money, is required for such a routinized operation.

Does this mean, as is from time to time suggested, that banks "have largely gone out of the banking business," to use Professor Warren's expression?[4] The answer to this question depends on how one chooses

[4] *Search for Financial Security*, p. 32.

to define banking, for the terms bank and banking are by no means conceptual absolutes. In Daniel Webster's day the essential feature of banking seemed to be, at least to Mr. Webster, the issue of bank notes. In terms of the usage referred to above, it evidently is, or was, lending to business.

The logic of the change in function is not that banks have ceased to be banks, or to be entitled to earn an income. But it raises a question as to the basis on which banks are to be compensated for the services they perform. When their chief function was the allocation of capital to productive uses, it was reasonable to look to interest for the income with which to maintain the banking system. If their chief function is to care for the community's liquid resources and to facilitate clearing operations, should they not look for compensation to those who are benefited by these services? *The Economist* of London has put this idea in specific terms:

> Over a period of years, the aim should be to shift the greater part of the burden of meeting the operating costs of banks—suitably abridged by all reasonable economies—on to the depositors, at least to the extent of charging, for the services performed, what they are worth to the recipient. If, after this has been done, there is any part of the total costs (including reasonable profits) which is not covered by (a) interest charged on advances, and (b) interest earned on securities purchased in the open market, then—but only then—a charge should be made for the remainder of the public debt held by the banks. In other words, the cost to the Exchequer of this portion of the national debt would be the net cost of operating the banking system, after all those for whom it performs services have paid for them. This net cost might well turn out to be nil, or even negative.[5]

To suggest that some of the same considerations apply in this country is not to advocate the nationalization of banks or their abolition. It is merely to point out that as custodians of the public debt (which they have acquired through exercising the sovereign function of issuing money) it is by no means obvious that they are performing a service that warrants the compensation they are receiving for it, while as administrators of the money supply they are clearly performing a valuable

[5] *The Economist,* Sept. 4, 1943, p. 312. In the same article *The Economist* declared that "the depositor cannot do anything else with his balances but leave them on deposit." Since it is through no fault of the depositor that he leaves such large deposits with the banks, one may perhaps inquire what justification there is for penalizing him for what he is powerless to avoid. *The Economist* is correct in saying that the total of deposits is not greatly dependent upon the action of depositors. But *The Economist* is quite wrong in suggesting that this was not the case formerly. For whether earning assets consist of the obligations of the government or of private debtors, the total volume of deposits is chiefly determined by the amount of earning assets and not by the choice of depositors.

*The Economist's* strictures tend, however, to obscure the point that while total deposits are largely independent of the action of depositors, except for the effect of their holding a larger or smaller amount of currency, the share of the total held by an individual bank within the banking system is very largely influenced thereby. Although the banking system as a whole could not expect to influence greatly the total of deposits through any inducements offered depositors, an individual bank might hope to affect materially the amount of its deposits. In the long run, of course, competition among banks to attract deposits might simply lead to a higher level of costs without lasting benefit to any bank. This may help to explain the resort to restrictions upon the more costly forms of banking competition, such as limitations on the payment of interest and on the granting of free services.

economic service. What we now have is an arrangment whereby a large part of the costs of services performed for depositors is transferred to the Treasury.[6] It is not clear that this has any permanent economic justification.

## III

The extent of variation among individual banks as regards policies, business, type of asset, and character of liabilities is almost infinite. For this reason any general statement as to the effects of recent changes is subject to contradiction on the evidence of particular banks. From the standpoint of the average, however, it is apparent that many of the old rules of bank management no longer have very much content. What, for example, is diversification when 70 per cent of a bank's portfolio consists of government obligations? It may, of course, mean diversification by maturities according to some preconceived idea of liquidity. But liquidity also has become virtually meaningless, for the time being at least, inasmuch as all government securities are fully liquid by reason of the policies now being maintained by the Federal Reserve banks.

The rule of a 1-to-10 ratio between capital and assets is still widely accepted as an ideal, but in actual application is chiefly honored in the breach. The evolution of the ratio shows a stairlike downward progression: ground is lost sharply but at substantial intervals, and is not regained. From June, 1939, to June, 1943, the ratio of capital to assets for all member banks fell from a ratio of 1 to 9½ to a ratio of 1 to 14½. For individual banks the ratio has fallen as far as 1 to 100, if not farther.

The change in ratio of capital to assets has implications entirely distinct from the more usual question of safety of deposits. A low ratio signifies the pyramiding of earning assets. The greater this pyramiding, the lower is the rate of yield on assets that is required in order to provide a given return on capital. The consequence of a greater pyramiding is a lessened incentive to seek the most profitable uses of the bank's resources. The effect might be, as in the case of tax-exempt securities, to divert funds into relatively riskless investments and away from venture capital.

The lowering of the ratio of capital to assets has served to offset the effect on earnings of the decline that has occurred in the rate of interest. It is obvious that if the return per hundred dollars of earning assets should drop to half what it was while the volume of earning assets doubled, earnings, *ceteris stantibus*, would remain the same as before.

[6] To the extent that banking services are now performed free for the Treasury, a change in the basis of payment such as *The Economist* suggests would not result in a saving to the Treasury.

To say that a decline in the ratio of capital to assets helps to compensate for a fall in the level of interest rates is not to suggest that this is the only, or necessarily a desirable, way of effecting such an offset. But it is apparent that two of the methods favored by supervisory authorities for strengthening the position of banks, namely, raising the capital ratio and maintaining earnings, may be in conflict with one another.

It is possible to exaggerate the depressive effect on bank earnings of the fall in interest rates.[7] Along with the decline in rate of return on earning assets has gone a great decrease in the interest paid on deposits. The difference between the rate paid on deposits and the rate received on loans and investments during and after the last war was frequently no greater than the net return now being received. In some instances it may have been less.

As judged by present standards, the rates paid on time deposits following the last war were very high. In 1920 about two-thirds of all national banks were paying from 4 to 5 per cent on time deposits. In addition, it was common to pay interest on demand deposits. In that year roughly 10 per cent of all demand deposit accounts bore interest. In Boston considerably more than half of all demand deposit accounts bore interest.[8] Since these were in general the larger accounts the proportion of interest bearing deposits by value was very much higher. Moreover, the rate paid was in many cases substantial: in 1920 approximately a quarter of all national banks paid from 4 to 5 per cent on demand deposits and some paid in excess of 6 per cent. While it is important that the decline in rate of return on assets has been partially compensated by a reduction in the rate paid on deposits, it is likewise significant that the further economies that can be made in this way are not large.

Before leaving the subject of interest rates, it may be remarked that the growth in investments has not rendered banks vulnerable to a rise in interest rates in as great a degree as is sometimes supposed. A large volume of bank investments is in the form of short-term Treasury securities. In June, 1943, Treasury obligations of less then one year's maturity constituted 20 per cent and those of less than five years' maturity 34 per cent of the adjusted demand and time deposits of all insured commercial banks. The corresponding percentages one year earlier were 6 per cent and 15 per cent. These assets are subject to no material deterioration with a rise in interest rates. At the same time, they are a means of obtaining cash in case of need, and that fact should make it easier for banks to hold on to longer term securities in case

[7] Cf. John H. Williams, "The Implications of Fiscal Policy for Monetary Policy and the Banking System," *American Economic Review*, Supplement, March, 1942, p. 245.

[8] Annual Report of the Comptroller of the Currency for 1920, Vol. I, pp. 112-114.

their market value should decline. For after all, a drop in the market value of government securities is not a very direct threat to banking solvency provided the bank continues to hold them until they return to par, which they assuredly would do when they matured if not before.

For all insured commercial banks the ratio of United States government bonds maturing in ten years or more to adjusted demand and time deposits fell from 14 per cent in June, 1942, to 11 per cent in June, 1943. In many individual banks, however, the proportion of these and other long-term securities is very high, and for them a rise in the interest rate would be a matter of serious concern. It has been suggested that it may no longer be feasible to employ changes in the interest rate to combat the business cycle.[9] Whether or not this will be true will depend partly upon whether bankers adopt a policy of holding high-grade securities to maturity regardless of temporary market fluctuations.

One effect of the concentration in Treasury obligations has been to dispose, for the time being certainly, of the long standing dispute over the shiftability or liquidity, in the self-liquidating sense, of bank assets. Today bank liquidity depends upon shiftability, and the focus of shiftability is principally upon the Federal Reserve banks.[10] With the tremendous volume of government securities in the portfolios of commercial banks there can be no question of lack of liquidity as long as the Reserve banks are able and willing to furnish cash in exchange for, or on the security of, Treasury obligations.

The establishment of a fixed rate at which the Reserve banks will buy or resell Treasury bills has provided a new mechanism for the automatic adjustment of member bank reserves. Instead of maintaining excess reserves a bank can hold Treasury bills with the privilege of exchanging them for cash at a moment's notice if the need arises; and if it has sold bills under a repurchase option it is able to exchange cash for bills on equally short notice. In effect, therefore, the posted bill rate together with the repurchase option means that banks have been given the privilege of earning ⅜ per cent on their excess reserves.

As long as the Federal Reserve banks continue to stabilize the market for government securities, not only bills but all Treasury obligations are as liquid as cash. The effect of this policy, if continued, would be to destroy the importance of length of time to maturity as a determinant of the liquidity of government obligations. The Reserve authorities have thus far refrained from making any public commitment with regard to the continuation of the policy of protecting the security mar-

[9] J. H. Williams, *American Economic Review*, Supplement, March, 1942, p. 240.

[10] This is not, it will be noted, the type of shiftability that figured in the earlier controversy. At one time shiftability implied the transfer of assets to other commercial banks. Today it signifies little more than their transfer to the Reserve banks.

ket. One important obstacle to stabilizing the market for government securities permanently is that guaranteeing the liquidity of longer term securities would aggravate the problem of maintaining the present differential in yields on longer and shorter maturities. Under the circumstances the Federal Reserve would presumably prefer not to promise to continue indefinitely to protect the price of longer-term government obligations. On the other hand, abandonment of the policy will not be easy.

It is reasonable to suppose that the authorities will do all in their power to prevent an initial break in the price of government securities from taking place. If it seemed necessary in order to maintain public confidence, the Reserve banks might conceivably agree to support indefinitely the market for government securities. The ideal policy, given the existing concert of interests, would seem to be a delicate balancing of confidence and fear with regard to the future of government securities. The purpose of such a balance would be to afford enough confidence to keep banks from any desire to dump government securities, while preserving sufficient uncertainty so that they would not lose all incentive to hold a substantial volume of short-term obligations.

The restrictions imposed upon different types of Treasury securities, particularly as regards those that may be purchased by banks, provide a precedent that conceivably might lead to considerably broader application. The effect of restrictions attached to various Treasury issues has been to stratify the market for its offerings. On the basis of policies already in operation, it would seem to be entirely possible, through restricting other alternatives, to compel banks to purchase short-term issues. In view of the abundance of bank resources and the limited outlets that exist for them, the Treasury might be able, if it chose, to create and maintain a market for low-yield securities. And it might be able to justify its actions in the eyes of most people, including perhaps many bankers, on the ground that short-term securities of this type are the most suitable for banks to hold.

The safety and liquidity of banks are no longer problems of the banks by themselves. Their focus is on the Federal Reserve banks. As long as the Reserve banks provide cash freely against government obligations, the commercial banks are highly liquid. The question therefore arises of whether the Reserve banks will be able to continue to assure the shiftability of bank assets. The influx of gold that began in 1934 and raised legal reserves of the Federal Reserve banks from 3,772 million dollars at the end of 1933 to 20,764 millions in 1941 seemed to have removed any possibility of a liquidity problem for the Reserve banks.

Policies such as the Reserve banks have been following can continue

as long as they are able to expand deposits. A check on such expansion is imposed by the reserves the Reserve banks themselves must maintain against notes and deposits. The ratio of these reserves declined sharply in the year and a half following the start of heavy war financing. In the last week of May, 1942, the ratio of reserves to Federal Reserve note and deposit liabilities was exactly 90 per cent. By the middle of September, 1943, it had fallen to 67 per cent. If the decline in the reserve ratio should continue at that rate, it would reach 40 per cent of notes and deposits by March, 1945. This is the ratio that for years has been tacitly accepted as the minimum below which the reserve ratio would not be allowed to fall.

It is, of course, by no means certain that the ratio will continue to fall so rapidly; already there is evidence of a slackening in the rate of decline. Even if it should reach the 40 per cent level, it does not follow that the Reserve banks would be prevented from continuing present policies. There are a number of steps that might conceivably be taken: reserve requirements for member banks could be reduced; the Treasury could draw down its deposit balances with the Reserve bank and its monetary powers might possibly be exercised to provide additional reserves; Federal Reserve notes could be substituted for silver certificates; there is always the legal possibility of falling below the reserve requirements, subject to the payment of penalty taxes on the amount of the deficiency; and, finally, it is entirely conceivable that the law might be changed to give greater freedom of action to the Reserve banks. The objection is raised to certain of these possibilities that either the Reserve authorities would not dare to have recourse to them, or that the public reaction would be so unfavorable that they would defeat their own purpose.

No conclusion is possible as to the probability of the Reserve banks themselves losing their liquidity, and with it their ability to contribute to the liquidity of the commercial banking system. For the present, at least, the question is academic. For some time to come Reserve banks will be free, without any modification in law or practice, to follow whatever policy circumstances require.

The changed policies of the Reserve authorities with respect both to protecting bank assets and providing member bank reserves constitute a modification of the framework within which banks operate. This is by no means the only change in the banking environment. The establishment of the Federal Deposit Insurance Corporation amounted, in essence, to a move to render tolerable a situation in which more fundamental changes, even changes as mild as the authorization of large-scale branch banking, were precluded. To say this is in no way to disparage the usefulness of the FDIC. But there is no use pretending that

by this simple means we gave ourselves an intrinsically strong or efficient banking system. Even the easy assumption that it has eliminated the danger of runs can scarcely be accepted as proved. Investigations by the Federal Reserve and others have shown that it is the large deposits and not the small that are withdrawn in time of uncertainty.[11] Inasmuch as the FDIC protects the small rather than the large deposits, the stable rather than the volatile, it remains to be seen to what extent the danger of future strains on banks has been removed.

With the reduction in private debt and the accumulation of currency, deposits, and government securities, individuals and businesses have reached a state of liquidity never before approached. In large measure this is a consequence of the manner in which the war has been financed. It might seem that when these funds are spent this situation of liquidity will disappear and business will once more have to depend to a considerable extent upon borrowing. This by no means necessarily follows. The effect of utilizing liquid balances will not be to exhaust them so much as to transfer them to other owners, leaving the liquidity of the system much as it was. Of the various ways in which this state of magnified liquidity might be moderated, the most obvious, though not necessarily the most probable, is a serious depreciation in the value of money.

It seems likely that unless this condition of extreme ease is altered liquidity preference is likely to carry a pretty low coupon. Into the many implications to theory and policy of the growth in liquidity it is not feasible to enter. But it is worth suggesting that monetary control, to the extent that it is operative at all, may hereafter be concerned much less than formerly with the quantity, and much more with the use, of money. For there is the possibility, on the one hand, that the release of liquid funds under conditions of full employment might have seriously inflationary effects and, on the other hand, that under conditions of growing unemployment they might help to maintain consumption and possibly investment, thus producing an automatic compensatory effect that would lessen the need for fiscal policies of a compensatory character.

The most intriguing aspect of these reserves of purchasing power is the long-run effect they may have upon the public's propensity to consume. Specifically, and very briefly, it is the possibility that the growth of these reserves may lead to freer spending out of current income.[12] It is conceivable that a point might, as a result, be reached where money saving was brought to a level corresponding to investment opportu-

[11] Cf. especially *Federal Reserve Bulletin*, March, 1939, pp. 179-183.

[12] Cf. S. Morris Livingston, "Wartime Savings and Postwar Markets," *Survey of Current Business*, Sept., 1943, pp. 12-18; and E. T. Weiler, "Wartime Savings and Postwar Inflation," *Survey of Current Business*, July, 1943, pp. 13-18.

nities. If such a balance should be achieved the importance of any future decline in the purchasing power of money might largely turn on the effect this would subsequently have in diminishing the public's propensity to consume, thereby creating again the possibility of deflationary tendencies.

Considerable concern has been expressed over the possibility after the war of an excess of savings such as would exert a heavy deflationary pressure. Estimates have appeared that with a national income of 150 billion dollars savings would be likely to reach between 26 and 30 billion, a sum greater, so it is argued, than probable investment. Any such conclusion as this implies certain assumptions with respect to the scale of postwar military and other expenditures by the government. At the present time the gap resulting from saving out of income is closed—and more—by military expenditures. Before the war it was not closed in that way. The question whether or not it will be closed after the war, and, if not, the magnitude of the gap that will remain to be closed by other means, will depend in large measure on the point, somewhere between the prewar level and the level now prevailing, to which government expenditures are reduced. In view of the uncertainty with regard to the future size of our military establishment and the multitude of other possibilities having to do with relief, reconstruction and so on, no reliable estimate is possible as to what this point will be. Yet predictions as to the future danger of deflation (which often seem to imply a return to the prewar level of government spending) are almost meaningless without it.

There probably never was a case of pronounced monetary expansion when people did not try to persuade themselves that conditions were different, and somehow inflationary consequences would be avoided. Without ignoring that disquieting thought, it is still relevant to point out that conditions today really *are* different. The probable effects of monetary expansion and an overgrown floating debt are not to be deduced from the events of past periods when present methods of controlling spending and credit operations did not exist. The fact that the ratio of floating and redeemable debt to total debt has risen does not necessarily prove that we are farther advanced on the road to inflation. It may merely presage future controls that will be firmer and more inclusive than what we should have known in the absence of this rise.

The logic of recent theoretical advances and the net of recent banking and monetary changes is that fiscal, monetary, banking, and business cycle problems are today uniquely and inseparably intertwined. If there is ground for concern in the fact that the degree of this intermingling is greater than ever before, there is at the same time reason for encouragement in the realization that our cognizance of the interrelations has increased even more rapidly.

# CENTRAL BANKING AT THE CROSSROADS

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Central banks—their functioning organizations, powers, objectives, instruments—can be understood in an historical sense only in terms of the milieu or basic apperceptions and attitudes of the people toward the prevailing social organization. The secular trend or major drift of central banking policy parallels, with a lag, changes in fundamental habits of thought. The development has not been smooth or uniform in rate. Periodically it is accelerated, retarded, or even reversed temporarily by important changes in political or economic affairs, of which the more common illustrations are revolutions, declarations of war, establishment of peace, and major periods of prosperity and depression. Finally, organizational, human, and apparently fortuitous elements may alter the development. Here come such factors as continuity of executive personnel, changes of generations, and personalities of force.

My observations will deal principally with two monetary and credit aspects of central banking policy; first, the relationship between government and central banks, and second, instruments of policy. Other monetary aspects will be mentioned briefly in the conclusion. Service functions, which require the overwhelming proportion of man-hours spent by central banks, which must be performed by somebody, and are performed efficiently by central banks, will not be discussed in this paper. Legal aspects will be treated only at one or two points. The law, of course, is important; but it frequently permits greater latitude than is commonly supposed;[1] and unduly restrictive legislation can be modified or suspended and will be so altered if the circumstances are sufficiently compelling.[2] I shall assume that the judgment of Dr. Vera Smith

[1] For example, there was no change from 1806 to 1936 in the French law governing the structure of the Bank of France. In 1814 censor Martin urged modification because he said the law gave the state power to govern and direct the Bank and reduced the powers of the shareholders to mere surveillance. (Banque de France, *Assemblée Générale du 27 janvier 1814*, pp. 20-31, especially 24-25.) In 1865 Governor Rouland said that the organization of the Bank was excellent, functioning in the hands of very experienced, very honorable men, cognizant of all interests. (*Enquête sur les Principes et les Faits Généraux qui Regissent la Circulation Monétaire et Fiduciaire*, Paris, 1867, pp. 654-664.) In 1935 the popular Front directed its successful political campaign against the same unchanged provisions because presumably they gave the shareholders complete control and deprived the government of power (a digest of its program was published in "L'Europe Nouvelle Documentaire," No. 30, Sup. to No. 937 of *L'Europe Nouvelle*, Jan. 25, 1936). Another example is the discount policy of the Reichsbank, which did not follow the expressed intentions of the framers of the Bank Act of 1875.

[2] For examples: the exemption of central banks from the operation of the usury laws in England in 1833 and in France in 1857; the periodic increases in the limit of note issues of the Bank of France; modifications in the so-called *steuerfreies Notenkontingent* of the Reichsbank; and suspensions of the Bank Act in England.

that "the belief in the desirability of central bank organization is universal" will continue to hold in the calculable future and shall not discuss what she calls the rationale of central banking.[3]

## I

In broadest outline, the history of central banks reflects the gradual ascendancy and subsequent decline of the doctrine of laissez faire and cognate habits of thought. This philosophy was not the product of any single individual. Embryonically, it had emerged in the sixteenth century, possibly even at the time of the Reformation. Great strides were made in that age of genius, the seventeenth century of Newton and Descartes, of Hobbes and Locke, of Milton and Dryden. The principles were applied to the field of economics by Hume and Adam Smith in the eighteenth century. Gradually they dominated the thinking not only of the geniuses but of the middle class which ascended to power as well. Gradually, too, they came to dominate one after another the various aspects of central banking until they permeated the entire field by the middle of the nineteenth century. Thereafter they declined. They were not at once superseded by new principles. At first technical modifications were introduced to meet existing needs. Such modifications, considered mere blemishes on the escutcheon of central banking theory, spread until theory and practice were at least separated if not divorced—an intolerable status. Recent developments have been in the direction of effecting a reconciliation of both with newer principles of social welfare.

1. *The Relationship between Governments and Central Banks.* The influences of fundamental philosophy on central banking theory and practice are illustrated in the history of the relationship between governments and central banks. Unfortunately for the scholar, it has been customary to settle disagreements between the two "consistent with the avoidance of unnecessary publicity," to use the expression of Governor Weguelin.[4] Even so, systematic analysis of the extensive information that is available, especially in such sources as *Parliamentary Debates* and *Papers*,[5] has been started only recently.

[3] Vera C. Smith, *The Rationale of Central Banking* (London, 1936), p. 1.

[4] *Parliamentary Papers*, 1854-55, Vol. 30, paper 465, p. 14. As Governor Lidderdale reported to the meeting of shareholders on Mar. 14, 1889, "There was necessarily a certain amount of confidential correspondence between the bank and the Chancellor of the Exchequer which would not be published . . ." *Bankers Magazine*, Vol. 49 (London, 1889), p. 471.

[5] It is not unreasonable to suppose that the apparent innocence of the distinctions between formal and informal, between consultation and conversations, studiously maintained in the official literature, is but evidence that, contrary to common belief, the boundaries between the two institutions were not at all precise. Elmer Wood, *English Theories of Central Banking Control, 1819-1858* (Cambridge, 1939), gives an excellent bibliography beginning on p. 221. Some pithy comments in the 5th series of *Parliamentary Debates* appear in

An obvious corollary of laissez faire is that if there is to be a central bank at all, it should be independent of the government. Not everyone held this faith—or these politics—when the Bank of England was founded.[6] A penalty was imposed on the directors should they lend to the Crown or buy Crown lands without Parliamentary consent because the Whig Parliament wished to tie the purse strings of the King, not to protect the Bank. For although Parliament closed the doors of the Bank to the King, it periodically visited the institution on behalf of its own finances. After the Bank moved its premises, it became known as the "Old Lady of Threadneedle Street"; and a significant part of its history touches the courting of the rich Old Lady by impecunious ministries in search of loans, and conversely the courting of sovereign ministries by the Old Lady desirous of favors. Advantages were gained by the ministries when they gave her a new lease on life by renewing her charter. Advantages were gained by the Old Lady when she enabled ministerial suitors to stave off financial embarrassment.[7]

Gradually, selected incidents of these relationships became part of the tradition of central banking history. The experiences under John Law and with the assignats in France and those of the Napoleonic period in both England and France were standard equipment. These incidents were exhumed carefully to demonstrate an inherent ineptitude, based on excessive spending proclivities, of government in the field of credit regulation. The conclusion that the bank should be independent of the government, which was exalted to an axiom, was in agreement with the experiences selected for analysis but not with all experience; it was derived from the inarticulate major premise, not from the evidence, which was a mere afterthought selected to be convincing.

Of course, there always have been those who refused to accept the

Vol. 85, col. 1286, Aug. 10, 1916 (McKenna); Vol. 166, col. 2053, July 17, 1923 (Joynson-Hicks); Vol. 181, col. 441, Mar. 4, 1925 (Churchill), col. 1519; Vol. 261, col. 1450, Feb. 16, 1932 (Chamberlain); see also Philip Snowden, *An Autobiography* (London, 1934), pp. 614-615, 840.

[6] "A true lover of our Constitution" argued in 1705 "that the Government will be . . . as it were in the Hands of the *Bank*, and may be undone either at long-run by being supply'd at too dear a rate, or at once by not being supply'd at all." *Remarks upon the Bank of England, with regard more especially to our Trade and Government occasioned by the present discourse concerning the Intended Prolongation of the Bank,* Humbly address'd to the Honourable House of Commons, By a Merchant of London, and a true lover of our Constitution (London, 1705), p. 29. And "a True Admirer of the Queen" asked in 1707 "whether they (the Bank) have not influenc'd many Elections for Members of Parliament . . . whether there has not been great sums of Money spent, for obtaining Elections for such Persons, as the Bank and New East-India Company approv'd of?" *Some Queries, humbly offer'd to the consideration of Both Houses of Parliament relating to the Bank of England,* By a True Admirer of the Queen, and Lover of his Country (London, 1707), pp. 1-2.

[7] For some of the details see J. R. McCulloch, *A Dictionary . . . of Commerce . . .* (Philadelphia, 1843), Vol. I. article "Bank of England," especially pp. 77-78. See also the general conclusions and references cited in S. E. Thomas, *The Rise and Growth of Joint Stock Banking* (London, 1934), Vol. I, pp. 14-16.

dualistic philosophy implied in the notion of an independent central bank, and who insisted that governments have a responsibility to see that powers of central banks are exercised in the public interest. In 1897 Pelletan spoke of the two hundred families and their dynasties who controlled the Bank of France; and Viviani revived a proposal, made by Proudhon in 1848,[8] that it be nationalized.[9] Periodic suggestions to the same effect were made in Germany, especially when renewals of the Reichsbank charter were under consideration.

Recent studies indicate that traditional notions based on incomplete evidence exaggerate the competence of the banks and the incompetence of governments. As to the competence of the Bank of England, for example, Professor Viner concludes "that the evidence available warrants the verdict that during the period from about 1800 to about 1860 the Bank of England almost continuously displayed an inexcusable degree of incompetence and unwillingness to fulfill the requirements which could reasonably be demanded of a central bank."[10] He shows that part of the inflations in Great Britain during the restriction period may be attributed to the commercial discounts of the Bank and that the ready yielding of the government to the wishes of the Bank that the floating debt be reduced rapidly after the Napoleonic wars added to the deflation.[11] As to the competence of the government, it was the government that forced the Bank to reduce its discount rate in the depression of 1822 and took the initiative in expanding the circulation in the same year.[12] The Bank came to the rescue of commerce in 1847—according to its own evidence—only after insistence on the part of the government, although to be sure the Act of 1844, according to Peel, relieved the Bank of all responsibility for currency management.

It is not possible to review in detail the historical evidence on the relative competence of central banks and governments in the field of credit regulation. Despite belief in the principle of bank independence, governments disagreed with central banks occasionally. Typical conflicts between them may be summarized reasonably accurately. Governments usually have been borrowers or, especially in depressions, have favored the cause of borrowers. Central banks typically have been controlled and managed by lenders, or the management has favored the lenders' point of view. Discussion was not carried on at this low level; instead both parties protested an exclusive interest in general welfare.

[8] Octave Noël, *Les banques d'émission en europe* (Paris, 1888), p. 114.

[9] *Journal officiel, Chambre Débats,* June 28, 1897, and June 10, 1897, with vote given on p. 1451.

[10] *Studies in the Theory of International Trade* (New York, 1937), p. 254.

[11] *Op. cit.,* pp. 168, 182.

[12] R. G. Hawtrey, *A Century of Bank Rate* (London, 1938), p. 14; Elmer Wood, *op. cit.,* p. 82 and citations listed there.

We need not question the motives which, for the most part, were genuine. Conflicts arose when the government insisted that the general welfare demanded an easier credit policy than the bank was disposed to adopt. Broadly speaking, the government's position was appropriate in periods requiring expansion and the bank's position was suitable in periods requiring contraction.

As long as depressions were blamed on God[13] or natural law,[14] it was easy to exonerate the bank of responsibility. And as long as major inflations occurred primarily when the government, especially in times of war, secured funds from the central bank, it was easy also to blame the government. In more recent times when it became agreed that an expansionary credit policy is appropriate in depressions, the record of the government vis-à-vis that of the bank was considerably improved. There is even danger that the pendulum has swung too far in the other direction. I shall return to the problem of the relationship between the two institutions in my concluding remarks.

2. *Instruments of Policy.* The rise and decline of laissez faire is reflected also in instruments of policy. A century and a quarter ago the major instrument of policy was rationing, both in England and France. In neither country was bank rate policy discussed; in neither was bank rate used systematically—in England before 1839 and in France before 1852; in both countries bank rate remained unchanged for very long periods—in England for seventy-six years on domestic bills and forty-nine years on "foreign bills," ending in 1822, in France for twenty-seven years, ending in 1847; in both countries bank rate was subject to usury laws—in England until 1833, in France until 1857.

Now rationing is a completely effective device for limiting the volume of credit to a predetermined maximum. It is not repugnant under certain conditions or to certain philosophies, but it is out of harmony with the tenets of laissez faire and natural law. It requires judgment and arbitrary criteria to administer, is easily subject to real or fancied abuse, and in general is personal. It was probably more workable in France because the Bank of France discounted many small bills for minor firms than in England where the Bank dealt largely with prime market paper. Despite efforts to impersonalize rationing through devices such as changes in the *échéance* or maturity of eligible paper, complaints against it persisted. As George Warde Norman put it, the Bank should not arbitrarily and capriciously reject credit "for no other reason than that enough had been discounted already."

In an unconscious effort to adapt their practices to the newer philosophy, central banks groped for an impersonal instrument that would

[13] Testimony of Governor Rouland, *Enquête sur . . . la circulation* (Paris, 1867), p. 672.
[14] *Parliamentary Papers*, 1840, Vol. IV, p. 39 (Cobden).

passively reflect the operation of "the natural laws of money." They discovered the rate and demonstrated that it satisfied the requirements. The shift from rationing to the rate did not come overnight. The actions of the Bank of England in the panics of 1825 and 1839 indicate its lack of confidence in an increase in the rate to limit the applications for credit.[15] Bank rate was changed only infrequently in the early years following the initial changes at the Bank of England and at the Bank of France. The experiences in the autumn crisis of 1847 greatly reinforced the case of those who held that increases in bank rate were an effective instrument of limiting the applications for credit. Once the rate was enthroned as the ideal instrument toward the end of the 1850's, it was changed to meet every gust of wind that passed through the economy. Bank of England rate was changed 202 times in the two decades from 1855 to 1874, including 24 changes in the single year 1873; Bank of France rate was changed 58 times in the decade from 1857 to 1866, including 11 times in the year 1864.

Bank rate was adjusted not only to fundamental long-run forces but also to such clearly temporary forces as seasonal changes in currency and reserves. These actions were a reflection of the doctrine of natural law that had been embraced by central bankers. De Germiny explained the many changes in Bank of France rate in 1857 in the following words: "You see here, gentlemen, many changes; but one would have tried in vain to avoid them: the price of money is a fact which one is never permitted to discuss."[16] A touch of envy of his English confreres may be detected in his report of January, 1863: "In England variations in the discount rate always follow those in the reserve. This economic law, verified through long experience, always applied without hesitation, is accepted without complaint by a public whose respect for sane doctrines is traditional."[17] Regent de Waru expressed the theory of central bank impotence in words that have become classic: *"La Banque ne fixe pas le taux de l'intérêt, elle le constate."*[18] This theory of the confirmation of natural developments or *Konstatierungstheorie,* as it became known, satisfied the requirements of laissez faire, natural law, and the equality of man.

Central banks, however, deviated from it in practice. The Bank of France virtually abandoned it in connection with seasonal variations after the parliamentary inquiry of 1865. Gradually one central bank

[15] "During the panic [of 1825] the bank began refusing discounts without at first increasing the rate to the legal maximum of 5 per cent, so little was its faith in the efficacy of the rate in the situation confronting it." Elmer Wood, *op. cit.,* p. 97. For the experiences in 1839 see *ibid.,* p. 97; for those in 1847 see R. G. Hawtrey, *op. cit.,* pp. 21-23.

[16] Banque de France, *Assemblée Générale du 28 janvier 1858,* p. 5.

[17] Banque de France, *Assemblée Générale du 29 janvier 1863,* p. 5.

[18] *Enquête sur . . . la circulation* (Paris, 1867), Vol. II, p. 708.

after another concluded that neither its own status nor market rates reflected consistently the real forces in the economy. Once central banks adjusted their policies to what they considered the real, as opposed to the apparent, factors, the foundation for an automatic *Konstatierungstheorie* crumbled. Central banking policy became in fact deliberative and purposeful. This was not admitted forthrightly. Instead, central bankers said they had merely developed a few minor instruments to make bank rate "effective." Fundamentally, however, automaticity ceases as soon as any element of judgment, however small, is introduced into the argument. In this instance, the minor instruments were developed into the major instrument known as open-market operations in modern central banking.

In like manner, central banks, while professing absolute faith in the Simon-pure gold standard, followed various practices to insulate national economies from the rigors of the genuine article. A catalogue of these devices used at one time or place or another would be long and would include: (1) variations in buying and selling prices for gold, (2) loans free of interest to importers of gold, (3) redemption of notes in lightweight coins, (4) redemption in silver, (5) redemption only at the head office, (6) dealings in foreign exchange. A curious lore of mysticism was accumulated to reconcile these blemishes with the automatic gold standard. The devices were evidence of a refusal by the central bankers to abide in day-to-day operations with the requirements of the theory they professed to accept. Emotions entered the daily operations, and the truth is, officials hated to see gold exported and rejoiced when it was imported. None of the devices was quantitatively important enough to offset persistent fundamental disequilibria in balances of payments. At the same time, small as they were, an intellectually honest appraisal must admit they are inconsistent with an automatic system; because frequently they were in fact interferences, not facilitating devices. Eventually, indeed, some persons raised a question of far-reaching importance. If a blemished gold standard is preferable to a Simon-pure gold standard, is it possible to construct—out of the blemishes possibly—an international mechanism that is better than either? After all, the extent to which central banks could deviate was limited only by custom and the laws of the land, not by divine or natural laws; and the limits could be extended by the simple expedient of changing the customs or the law.

With the first World War and its aftermath there was a shift throughout the world from economic internationalism to highly nationalistic economic policies. Maintenance of international equilibrium gave way to insulation of domestic economies against foreign influences. Innumerable ingenious trade barriers and exchange controls were adapted

to implement this economic nationalism. Former influences underlying international relationships gave way to narrow provincial ambitions. Instruments of central banking policy were not at once adapted to the newer objectives. Although an occasional author even before the first World War urged central banks to extend their functions from administering a mechanical discount rate policy to exerting an organic control over the money market,[19] the rate remained the prime instrument of control in theory and practice until the twenties.[20]

During the twenties the Federal Reserve System developed open-market operations not merely as an ancillary tool to make bank rate effective, but as a coequal instrument of policy, especially to offset the effects of gold movements. The development of a theory of open-market operations led to an analysis of the tradition against rediscounting—whose importance as an instrument of central banking policy has, in my opinion, been exaggerated. In the thirties not discounts but excess reserves, resulting largely from gold imports, occasioned concern. In 1933 and 1935 the System was given a new instrument[21]—power to change reserve requirements—to cope with the problem. This instrument reinforced the powers of the System over member bank reserves, but excess reserves remained large even after requirements had been raised to the maximum permitted by law.

The adoption of active credit policies in the depression was accompanied by formal abandonment of an older "automatic" instrument. The discount provisions (Section 13) of the original Federal Reserve Act were based on the disproved[22] supposition that properly drawn eligibility rules would control credit adequately. The Congress admitted "the great difficulty of defining 'commercial paper' " and left the problem to the Federal Reserve Board.[23] Although the principle of self-liquidation supposedly was clear, the System encountered administrative difficulties in defining eligible origins or uses of funds.[24] In principle, however, it attempted to adapt the automatic system to American conditions including political conditions. Gradually the reserve officials lost faith in the self-liquidating theory, especially as a primary method of extending Reserve bank credit became the advance, collateralled by government securities, rather than the rediscount. In its famous *Tenth*

[19] For example, Johann Plenge, *Von der Diskontpolitik zur Herrschaft über den Geldmarkt* (Berlin, 1913), especially pp. 32 ff.
[20] The Cunliffe Committee, *First Interim Report,* p. 6; Enquete-Ausschuss, *Die Reichsbank* (Berlin, 1929), p. 59.
[21] The Board had requested the power in 1917; *Third Annual Report of the Federal Reserve Board* (Washington, 1917), pp. 22-28, 140.
[22] Disproved, for example, by Henry Thornton, *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* (London, 1802), pp. 30-32.
[23] 63rd Congress, First Session, House of Representatives, *Report No. 69,* p. 48.
[24] The earlier history of the problem is given in Waldo F. Mitchell, *The Uses of Bank Funds* (Chicago, 1925).

*Annual Report* the Board wrote: "There are no automatic devices or detectors for determining, when credit is granted by a Federal Reserve Bank in response to a rediscount demand, whether the occasion of the rediscount was an extension of credit by the member bank for non-productive use."[25] As confidence in the principles of eligibility waned, the rules were made more lenient. Beginning with the program of the President of October 7, 1931, the depression delivered a series of blows which marked the end of eligibility as a control device.[26] At first amendments were passed to meet particular conditions. The Banking Act of 1935, however, contained a provision that abandoned the old theory *in principle,* by providing that "any Federal Reserve Bank may make advances to any member bank on its time or demand notes which are secured to the satisfaction of such Federal Reserve Bank." The Board of Governors stated that the new principles "mark a definite recognition of the fact that the lending function of the Federal Reserve banks is not automatic but is an instrumentality of the System's general credit policy."[27]

In 1938 the Board of Governors discussed the possibility of creating an instrument of policy out of its supervisory activities and formally raised the question: "Can the examination policy of the several Federal supervisory agencies be further co-ordinated to promote the effective functioning of the entire banking system, making it a force toward increased national economic stability?" The national supervisory agencies agreed to a common procedure in bank examination, but it is not clear from the published reports that supervisory policies have been uniformly integrated into general credit policy.[28]

To facilitate the adjustment of the money market to changing conditions, technical modifications were introduced in 1942 in the procedure of extending Reserve bank credit. The Reserve banks, in conformity with directions from the Federal Open Market Committee, announced their readiness to purchase Treasury bills at a rate of ⅜ per cent per annum and later granted a repurchase option at the same rate.

[25] *Tenth Annual Report of the Federal Reserve Board* (Washington, 1924), p. 35 and also pp. 33-34; *Eleventh Annual Report of the Federal Reserve Board* (Washington, 1926), pp. 14-18; 67th Congress, first session, *Hearings on Senate Concurrent Resolution 4* (Washington, 1921), Part 13, pp. 284 and 417.

[26] See *Federal Reserve Bulletin,* Oct., 1931, pp. 551-552, *Nineteenth Annual Report of the Federal Reserve Board* (Washington, 1933), p. 205. The following legislation also enlarged eligibility provisions: the Glass-Steagall Act of Feb. 7, 1932, the Acts of Feb. 3, Mar. 9, Mar. 24, and May 12, 1933, the Banking Act of 1933, the amendments of June 19 and 27, 1934.

[27] *Federal Reserve Bulletin,* Oct., 1937, p. 977.

[28] *Twenty-fifth Annual Report of the Board of Governors of the Federal Reserve System* (Washington, 1939), pp. 6-18, 89-90, especially pp. 17-18; *Seventy-seventh Annual Report of the Comptroller of the Currency* (Washington, 1940), p. 8; *Annual Report of the Federal Deposit Insurance Corporation for the Year ending December 31, 1938* (Washington, 1939), pp. 16-28, especially pp. 17 and 23.

This device provides funds where they are most needed; it also avoids the tradition against rediscounting. It is used to provide reserves, and together with traditional open-market operations enables the System to maintain satisfactory conditions in the government security market.

In the past decade the Reserve System has been directed to employ instruments outside commercial banking and organized money markets. I shall mention these only briefly at this point and shall discuss them in the summary. In the first place, Reserve banks have been authorized under certain circumstances to make working capital loans to established industrial or commercial businesses. In the second place, the Reserve System has been designated to administer two instruments of selective credit control—regulation of security loans and of consumer credit—which establish certain credit terms under which third parties may enter contracts.

In summary, the most important development in instruments of policy in recent decades is the fundamental shift from faith in automatic laws to dependence upon human judgment. As a consequence, (1) central banks are being empowered to administer and to adapt as instruments of policy elements once rigidly enacted as law, (2) the sphere of influence is being enlarged from dealings with member banks and the open market to a much wider field of credit operations, and (3) the mechanics of operation and supervision are being adapted as instruments of policy.

## II

The two major drifts—toward laissez faire until roughly the middle of the last century and away from it since—have been accelerated or retarded periodically by major changes in political or economic conditions.

In major wars the government of the day in the belligerent countries has had its way with the central bank, and usually the government has secured funds directly or indirectly from the central bank. Funds have not always been granted willingly, but they have been granted.[29] In-

[29] Except possibly for quaintness of expression the following quotations describe wartime conditions in other countries and at other times as well as those in England during the Restriction period: *Parliamentary Papers,* 1819, Vol. III. Vansittart usually addressed the Governor and Deputy Governor somewhat as follows: "I beg leave to acquaint you, that it will be an Accommodation to the Public Service, if your Court will consent to exchange the Exchequer Bills dated . . . for a like Amount to be dated . . . I request therefore you will have the goodness to move your Court to consent to such Exchange accordingly." In the case of purchases (as contrasted with exchange) of bills, it was a "great Accommodation to the Public Service" or even a "very great Accommodation." Ordinarily the Court resolved to comply with the Chancellor's letters. Not infrequently, however, they imposed conditions, especially concerning repayment. For example, the Bank became increasingly concerned in 1814. They had agreed to purchase 8 million from May 5 to June 9. They agreed to a further purchase of 2 million on June 16 "on account of the urgent Necessity of Government, under the peculiar Circumstances of the Moment, and

struments of policy have been adjusted to the desires of the treasury.

Major wars customarily have been accompanied by inflation of varying but considerable intensity. Sooner or later they have been followed by demands for the establishment or restoration of independent central banks. One need only recall the heated discussions and numerous resolutions following the first World War to illustrate the point. The same basic arguments were advanced in both France and England after the Napoleonic Wars. Governments have dictated to the bank also in matters involving foreign policy[30] or in times of great national crises, such as revolutions.[31] The willingness of the bank to make concessions and the abilities of the government's representatives were not uniform, but strong governments have had their way.

Governments have secured concessions from central banks, have themselves performed central banking functions, or have endowed other institutions with them in periods of severe depression.[32] Experience during the Great Depression illustrates this point, but experiences during earlier ones are equally convincing.

## III

The policy of a central bank at a moment of time reflects the balance of power among individuals and agencies who influence it, primarily the top management.[33] At most central banks the executive personnel as a whole is a continuing group composed of persons who individually serve long terms. Policy is determined usually by experienced members who have acquired power and prestige. Honor of membership in the select circle rather than influence is the greatest reward of new members.[34] By the time they in turn have gained power with maturity they

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also that so large a Portion of the said Advances is settled to be paid off out of the Instalment of the present Loan." Three weeks later they agreed to purchase another 2 million. "But the chairs to acquaint the First Lord of the Treasury and the Chancellor of the Exchequer, that the Court cannot grant any further Advances; and expect such Arrangements may be made as shall tend to a very considerable Reduction of the present enormous Amount of these Advances." Nevertheless, the request of July 28 for yet another 2 million "was Reluctantly complied with, under the Assurance that every Endeavour will be made to bring the Advances of the Court within reasonable Bounds as soon as possible."

[30] The only cases of governmental interference with Reichsbank policy, despite the legal relations, before World War I were of this character; see Albrecht Sommer, *Die Reichsbank unter Hermann von Dechend (1865 bis 1890)* (Berlin, 1931), pp. 80, 91-96.

[31] See my "The Government and the Bank of France," in C. J. Friedrich and E. S. Mason (eds.), *Public Policy* (Cambridge, 1941), Vol. II, pp. 24-28.

[32] E. A. Goldenweiser, "The Federal Reserve System Today," in George B. Roberts' (ed.) *A Forum on Finance* (New York, 1940), pp. 76-77.

[33] The actual balance may differ considerably from the legal provisions; see my *The Agencies of Federal Reserve Policy* (Columbia, 1935), "Die Politik der Deutschen Reichsbank seit der Stabilisierung" in *Weltwirtschaftliches Archiv* (1935), Vol. 42, pp. 445-481, "The Government and the Bank of France," *loc. cit.*, pp. 1-35.

[34] Chapter 8 of Walter Bagehot's, *Lombard Street*, first published in 1873, still merits perusal. Of 354 directors at the Bank of England between 1694 and 1900, 115 served 20 years or more, 54 served 30 years or more, 20 served 40 years or more, and 2 served 50 years or more. Of 141 regents at the Bank of France from 1800 to 1935, 30 served 20

have absorbed the cautious wisdom of their predecessors at the expense of their zest for innovation. Furthermore, until recently, new members have been chosen from the same general social stratum—in some countries indeed from the same firms or families—and have held the same views as their predecessors. This continuity is one of the prime factors in explaining why fundamental changes in social philosophy have been slow in affecting central bank policies.

Occasionally, however, when the policies of a central bank are too far out of line with what is expected of the bank, its personnel is changed, sometimes with a change in the law, sometimes without. Illustrations are the changes in the Bank of France in 1936 and in the Reichsbank, beginning with the advent of Hitler.

It should not be inferred that what is expected of the bank is always reasonable. In a much less pronounced degree and very much more gradually, changes in personnel also have taken place in the Federal Reserve System after 1933. Among the basic difficulties here were the inhibitions and restrictions growing out of the self-liquidating theory of eligibility, failure to distinguish between policies and actions appropriate to the central bank and those of commercial banks, some misconceptions as to the function of reserves both at commercial banks and at reserve banks, and some acrimony against all banks and bankers.

Occasionally continuity is broken also by what Bagehot, in another connection, called "a change of generation."[35] such changes are non-deliberative and occur when a considerable proportion of influential individuals who have resisted new ideas just happen—because of death, retirement, etc.—to leave office at the same time or nearly at the same time. The best illustration I have been able to find is the case of the Bank of France in the 1850's. The Bank entered that decade a staid, stolid, tradition-bound, one might almost say moribund, institution. Within five years half of the top management was new; and almost overnight—as history reckons time—its policy was revolutionized. The new management developed new policies based on laissez faire, shifting in instruments from rationing to changes in the rate. At times opposing forces striving for power are so delicately balanced that policy itself vacillates as first one and then another group gains the decision. Tooke describes such an instance at the Bank of England in 1836-37.[36] Finally, a single individual may dominate a central bank so completely that the history of the institution for a period can be written accurately

years or more, 12 served 30 years or more, 6 served 40 years or more, and 2 served 50 years or more.

[35] *The English Constitution* (London, 1894), Introduction to the Second Edition, pp. x-xi; "What we call the 'spirit' of politics is more surely changed by a change of generation in the men than by any other change whatever."

[36] Thomas Tooke and William Newmarch, *A History of Prices* (London, 1857), Vol. V, pp. 619-620.

only with reference to that individual's life. Montagu Norman, Hjalmar Schacht, and Benjamin Strong are well-known examples.

## IV

Central banks must adjust themselves to changes in environment, including those in fundamental human ambitions, desires, and expectations. Anticipation of Federal Reserve problems, therefore, should be based on analyses of the objectives the System may be expected to achieve, the conditions under which they may be expected to operate, and the instruments available.

Objectives with widespread support include maintenance of real national income at a high level, prevention of inflation, maintenance of satisfactory conditions in the government bond market, and participation in world rehabilitation. The war has retaught most of us that such comprehensive objectives can be achieved only through the utilization of many material and spiritual forces. Central banks are not magicians and cannot achieve them alone. I think we must expect that many will again forget this lesson as insistent and impatient demands are made for immediate results. Many false prophets will rise, saying, "Here is the solution," or "There is the solution." And there will be neither flaw in the logic of some of these prophets—except relevancy to the real world—nor lack of cogency in their rhetoric.

Development of policies to maintain real national income at a high level unquestionably is important; but it has held the center of the stage so long that I can add little to the discussion, except to say that removal of some of the limitations on loans under Section 13(b)[37] might be helpful. The Federal Reserve should not compete with other agencies in this field. At the same time, resources should not remain idle for the sole reason that funds are not available. Experience with 13(b) loans generally has been good. A wider field of usefulness could be opened by removing the requirements that such loans be made only to established businesses, for working capital purposes, and not in excess of five years. After the war, however, we may be faced, as we have been after other wars, with inflationary developments. This may not be the only problem, but it may be desirable to analyze whether existing instruments are suitable to curb such developments.

The chain that joins open market operations, bank rate, bill policy, and reserve requirements with the volume of expenditures consists of several links. Use of the instruments affects total reserves, excess reserves, or both. Excess reserves condition but do not determine changes in the money supply.[38] The supply of money influences but does

[37] Limitations on maturities, type of borrower, and purpose of loan.
[38] As we learned again in the depression. Excess reserves were not a new phenomenon.

not determine the flow of money through the economy. General instruments are most effective when this chain is taut. Policies adapted first to the depression and then to war finance, however, have slackened the chain, injecting play at each link.

The question of adequacy relates to the extent of power relative to the job to be accomplished. Power may be measured by the ability of the Reserve System to absorb reserves. At the end of last year the System could have absorbed a billion dollars by increasing reserve requirements to the legal maximum. Assuming it were willing to dispose of all its earning assets, it could have absorbed 12 billion dollars more—a total of 13 billions. To this sum should be added any reduction that may occur in gold stock. The size of the job is indicated by the amount of reserves that might have to be absorbed. This factor cannot be measured directly, but its general order of magnitude may be indicated. On December 31, 1943, member banks held a billion dollars of excess reserves. In addition, they held 11½ billion dollars of required reserves and there was 20½ billions of currency in circulation. If one makes reasonable assumptions as to the minimum to which these items may be reduced, it may appear offhand that existing general instruments are adequate, although in the absence of knowledge as to our possible international commitments, we cannot be sure.

Viewed as a practical rather than technical matter, the economy has another means of producing reserves. A very large and rapidly increasing volume of government securities either is redeemable virtually on demand or matures very shortly. The Federal Reserve System is the source of funds that would enable the Treasury to meet its obligations if the remainder of the economy did not supply them. Existing general instruments of central banking policy would prove wholly inadequate to offset the possible effects on reserves that would result from the exercise by the owners of their right to redeem or not replace maturities. Removal of limitations on control over member bank reserves, however, would increase central banking powers adequately for the purpose.

Extent of power relative to the size of the task to be performed is not the only aspect of the problem. Another phase is the willingness or desirability of exercising the powers. This is a matter of policy. The decision would be based upon an analysis of the entire situation. It would be important, for example, to know the source of the reserves. If they came from a return flow of currency, traditional instruments could be employed, especially in view of the maturity distribution of the System's portfolio. If, however, they came from disposal of government securities by owners who wished to spend the proceeds, use of

See 61st Congress, second session, *Senate Document 509* (Washington, 1910), Plate No. 22, for the occasionally very large excess reserves in the period 1869-1909.

traditional instruments to halt inflationary developments might interfere with the maintenance of satisfactory conditions in the government bond market.

It has been argued with cogency that high levels of productive employment would produce savings in such volume that one need not be concerned about the future of the government bond market. On the other hand, many doubt the ability of the authorities to support that market when commodity prices are rising, without aggravating inflation. Experiences during the first year and a half after the first World War indicate that we should be prepared for such developments.

The devastating repercussions of either inflation or a severe break in government bond prices makes imperative a search for techniques to prevent both. The remainder of my remarks will be devoted to introducing some of the alternatives. A scarcity of funds in the government bond market and a plethora of funds elsewhere could, of course, be remedied by restricting—through rationing, priorities, and direct controls—the uses to which "outside" funds could be put. All such controls should not be removed with the end of the war, but as a permanent matter this remedy is worse than the disease it purports to cure. This discarded alternative, however, indicates the nature of the problem. What is needed is an instrument or combination of instruments the net effect of whose operation is to absorb funds elsewhere but not from the government bond market—in short, an appropriate technique of selective credit control. If money were completely fluid in and among all markets, no such technique could be devised.

We have evidence, however, that money is far from fluid. For example, the easy money conditions of the thirties resulted in the interest rate structure with which we are all familiar. We are now confronted wth resolving the inconsistency inherent in maintaining that structure and at the same time maintaining the element of uncertainty that the structure presupposes. Other evidences of lack of fluidity are the volume and distribution of excess reserves during the past decade and the widely varying sensitivity of particular interest rates to excess reserves.[39]

The viscosity of money offers hope that techniques can be devised to exert different degrees of pressure in selected areas. Furthermore, the degree of viscosity may itself be modified—as it has been through limitations on the acquisition and disposition of certain issues of government securities. What instruments are available to the Reserve authorities to devise such a technique? They are the conditions under which the System will extend credit at the initiative of the market,

[39] John H. Williams, "The Implications of Fiscal Policy for Monetary Policy and the Banking System," in *American Economic Review*, Sup. 1, Mar., 1942, p. 244.

operations in the open market, changes in reserve requirements, and the so-called "selective instruments": regulation of security loans and of consumer credit. The first two, which are usually described as general instruments, are in fact also selective at the present time because they operate almost exclusively through government securities. For this reason they are not ideal as restrictive instruments but are suited to give needed support to the government securities market. The posted bill rate makes funds available where they are most needed without encountering a tradition against rediscounting. Other operations in the open market permit maintenance of desired relationships among different issues and are adaptable to counteracting stresses and strains in the central money markets where such operations are executed.

Changes in reserve requirements ease or increase general pressure. To be sure, part of the general pressure could be absorbed through reduction in excess reserves and a still larger part through disposal of government securities by member banks, but a part also would tend to force reductions in other earning assets. Increases in reserve requirements to exert general pressure combined with discount policy, bill policy, and open-market operations to relieve the pressure in the government securities market, though apparently contradictory, may instead—as the Federal Open Market Committee pointed out in April, 1937—be complementary.[40] Existing limits on the power of the Board of Governors over reserve requirements would, of course, have to be altered or removed to carry out such a program.

The so-called "selective credit instruments" could be adapted to this program without difficulty. It might prove desirable to extend them to other fields, such as housing. The technique of such regulation might be modified. For example, it would be in keeping with the history of earlier instruments if Regulation W developed away from control over individual transactions toward over-all regulation of the volume of such credit in particular fields. I am not sufficiently familiar with the technical or administrative aspects to know how this could be done practically. The nature of the distinction, however, may be illustrated. Instead of setting terms for individual contracts, it might be possible to devise a technique—I mention minimum collection ratios to illustrate the point, although I am told that they are not administratively feasible—to obtain adequate control. The chief purpose of such a method

[40] On April 4, 1937, the Committee issued the following statement: "With a view (1) to exerting its influence toward orderly conditions in the money market and (2) to facilitating the orderly adjustment of member banks to the increased reserve requirements effective May 1, 1937, the Open Market Committee of the Federal Reserve System is prepared to make open-market purchases of United States Government securities for the account of the Federal Reserve banks in such amounts and at such times as may be desirable." *Twenty-fourth Annual Report of the Board of Governors* (Washington, 1938), p. 6.

is that it would permit greater freedom in individual transactions and yet achieve the objective of regulating the volume of the particular type of credit. It might prove desirable also to establish different requirements in various parts of the country.

The concept of selective credit control as contrasted with purely quantitative or traditional qualitative controls arose during the twenties particularly out of developments in the security market. The experiences that culminated in the crash of 1929 led to regulation of margins on security transactions. Control over consumer credit developed from a desire to limit nonwar expenditures. In longer perspective selective controls received an impetus from the experiences in the depression when efforts of the Reserve System to stimulate activity through easy money policies were dissipated largely in excess reserves. Since pump-priming expenditures injected funds directly into the national income stream at various levels, some concluded hastily that central banking instruments had lost their potency permanently.

The developments I have described suggest the possibility that we could be confronted with conditions in which central banking instruments, far from being impotent, would be too powerful to be used alone.[41] Under such circumstances a reversal of pump priming could be allied with central banking policy.

Such an adaptation would be directed to taxing and borrowing from the segments of the economy that are getting out of hand despite selective controls sums sufficient in amount to halt inflationary developments.[42] The difference between funds taken in and those paid out would be sterilized, for example, by deposits in the Treasury account at the Federal Reserve banks or by retirement of government securities held by Federal Reserve banks.

This analysis raises again the question of the relationship between the government and the central banking system. There is no easy, clear-cut answer. Government is or should be responsible to the electorate for dealing with social and economic problems. The central bank is charged with the administration of broad monetary and credit policies. It is obliged to present its monetary point of view with courage. Its powers must be exercised in the public interest. Its strength must derive from demonstrated competence. The bank may be forced to yield if the administration in power loses confidence in it for whatever reason;

[41] The skeptic may consider the power—which might be granted to the Board of Governors—of doubling, tripling, or quadrupling reserve requirements, or the existing power of disposing of $12 billion of earning assets. The whole problem of reserves may call for reconsideration after the war. Reasons have been developed in the *Report of the Committee on Bank Reserves of the Federal Reserve System: Member Bank Reserves* (Washington, 1931), and subsequent discussion.

[42] Including those resulting from governmental expenditures and either Federal Reserve or Treasury purchases of government securities.

but the electorate, not the government of the day, must have the final say in a democracy,[43] even though the immediate decision may be wrong.

Bitter experiences show that neither an independent nor a subservient central bank produces satisfactory results in the long run. A proper legal structure of all agencies concerned with broad monetary and credit policies, including methods of selection, qualifications, terms of office, and similar factors affecting central banks, is helpful in securing and maintaining an appropriate middle ground, but law alone does not insure wise policy. I believe that a shift in emphasis from insistence upon rights, sovereignty, and independence to comprehension of duties and responsibilities for social welfare would aid in establishing relationships between the two institutions appropriate to existing conditions. I hope there may be comments as to how this shift may be brought about with full knowledge that each generation has the problem of adapting its inherited institutions in such a way as to hold the balance true between tradition and innovation, between independence and subservience, between freedom and authority.

[43] The following quotations from chief executives of central banks reflect this point of view:

Chairman Eccles testified: "It seems to me that an administration is charged, when it goes into power, with the economic and social problems of the nation. Politics are nothing more or less than dealing with economic and social problems. It seems to me that it would be extremely difficult for any administration to be able to succeed and intelligently deal with them entirely apart from the money system. There must be a liaison between the administration and the money system—a responsive relationship. That does not necessarily mean political control in the sense that it is often thought of." (74th Congress, first session, House of Representatives, *Hearings on Banking Act 1935*, Washington, 1935, p. 191.)

Governor Norman testified: "I think it is of the utmost importance that the policy of the bank and the policy of the government should at all times be in harmony—in as complete harmony as possible. I look upon the bank as having the unique right to offer advice and to press such advice even to the point of 'nagging'; but always, of course, subject to the supreme authority of Government." (Royal Commission on Indian Currency and Finance, London, 1926, Vol. V, question 14597—see, however, also questions 14598 and 14605-14609.)

President Luther said: "I do not know what meaning the cogent demand, that the Government should lead, can have, if one does not in our present situation follow a Government that leads." (*Ansprache*, Nov. 29, 1930, *Reichsverband der Deutschen Industrie*, Berlin, 1930, p. 15; see also the strained logic in his letter of resignation to Reich President Hindenburg, dated Mar. 16, 1933.)

See on the same point E. A. Goldenweiser, *loc. cit.*, pp. 76-78, and testimony of J. M. Keynes before the Royal Commission on Indian Currency and Finance (London, 1926), Vol. V, questions 13055-13061.

## DISCUSSION

William W. Tongue: The papers of Professor Whittlesey and Dr. Bopp, although concerned with the field of money and banking, raise fundamental questions about the future of our society. Is our economy in the future to be based primarily on private enterprise, as in the past? Or is it rather to become more and more a planned economy, subject to ever widening spheres of administrative control by the government? Most of us would agree that the latter alternative is undesirable—*if* the private enterprise system can create and maintain relatively full employment indefinitely. If it cannot, "planning" will inevitably take over, irrespective of the dangers this might involve to the civil and economic liberties we cherish.

We know that in the past the private enterprise system has been characterized by frequent periods of pronounced unemployment—unemployment which in the future will presumably not be tolerated. This means that if the private enterprise system is to survive some system of control must be devised which will be compatible with private enterprise and which at the same time will be capable of maintaining reasonably full employment. Such a system of control must be of wide enough scope to affect significantly the course of the entire economy. At the same time it must be sufficiently general so that it does not interfere directly with the decisions of individuals and business firms. Two such policies come to mind—a compensatory fiscal policy, and central banking policy operating through changes in the quantity of money.

Fiscal policy is not the subject of this meeting, but a few words regarding it might be in order. The record of compensatory fiscal policy to date is certainly not a good one. In the thirties, deficit financing failed to stimulate a large volume of private investment—in part at least because it generated the fear of government competition and raised the specter of increased taxes in the future, thereby lowering the return on newly invested capital. In the wartime inflationary period it has been found impossible to obtain a sufficiently restrictive tax program to check inflation and reliance has therefore been placed on direct controls. Moreover, changes in fiscal policy must inevitably lag considerably behind changes in the phases of the business cycle, especially where control over the purse strings is in the hands of Congress and is likely to remain so. This is not the whole story on fiscal policy, by any means—but it should be recognized that fiscal policy is not the cure-all it is sometimes assumed to be.

We are left then with central banking controls over the quantity of money. Neither Professor Whittlesey nor Dr. Bopp seems very sanguine about the possibility of controlling the business cycle through changes in the quantity of money. Dr. Bopp bases his pessimism partly on the drift away from laissez faire—Professor Whittlesey on the changes in the character of bank assets and the phenomenon of large and fluctuating excess reserves which may neutralize the effect of central banking policy.

Specifically, because of the large amounts of liquid assets accumulated by business firms and consumers, and because of other factors, we are more likely

to be confronted with inflation than deflation in the postwar period. The Federal Reserve System will then be faced with the choice of stabilizing the government bond market or of pursuing a deflationary policy such as open-market sales of government securities. As Professor Whittlesey points out—and it is a point which cannot be emphasized too strongly—a policy of stabilizing the government bond market may mean that part of the approximately 60 billion dollars of government securities held by the commercial banks will acquire the attributes of excess reserves. This will be particularly true if banks become convinced that the Federal Reserve System has the capacity and the intention to stabilize the market indefinitely. In that event there will be a strong inducement for commercial banks to liquidate part of their government security holdings to acquire any high grade securities which promise to yield more than government bonds. This cannot fail to have an inflationary effect on markets for lower grade securities and common stocks—and hence on the economy in general.

On the other hand a deflationary policy, which in any case might be difficult to carry out in the face of almost certain opposition from the Treasury, might result in "devastating repercussions." Possibly Dr. Bopp means by this that the solvency of the banking system would be threatened. I think Professor Whittlesey's statement that banks hold government securities of less than one year maturity amounting to 20 per cent of their total deposits indicates that this problem would not be great.

He may also mean that a break in the government bond market might be carried so far that it would spread to other security markets, and in this way bring on a depression in which purely monetary policy would be of no avail. This is of course a question of judgment, as to the timing and extent of action. But in any case, if the policy is carried too far and results in deflation, purely monetary policy is by no means helpless in periods of depression. I do not accept the thirties as conclusive proof on this point. Never since the "stagnant seventies" have we had such a prolonged period of monetary deflation as in the thirties. The easy money rates on high grade bonds did not result so much from a plethora of funds as from the general desire for liquidity. Yields on stocks and lower grade bonds could not by any stretch of the imagination be called "easy." Vigorous open-market purchases in the summer and fall of 1930 might have had a stimulating effect on the securities markets and turned the tide. This is what often happened in depression under the old national banking system when the return of currency from circulation would eventually pile up reserves in New York City rather than pouring them down the gullet of the Federal Reserve banks through reduction in rediscounts.

In any case, Dr. Bopp feels a course can be steered between the "devastating repercussions of either inflation or a severe break in government bond prices." He offers selective credit controls as the way out—although I am not at all certain that he feels quite satisfied with this solution. Professor Whittlesey also suggests this as a possibility.

My own feeling about selective credit controls is that they are likely to be so selective as to be virtually impotent in controlling the economy as a whole—or if they are to be of sufficient scope to be effective on the economy as a

whole they will be difficult to distinguish from other direct controls administered by officials who decide what and how much of what is desirable or undesirable. The latter alternative is presumably as distasteful to Dr. Bopp as it is to me.

There is one further point in Professor Whittlesey's paper on which I should like to comment, although it is not necessarily germane to this discussion. That is the point regarding the effect of changes in the character of bank assets on the automatic response of the banks to the volume of transactions. Unquestionably the decline in the relative amount of short-term business indebtedness to banks will make it less likely that the quantity of money will decline sharply in periods of depression. On the other hand I fail to see that relative stability in the volume of the public debt in the future will exercise a restraining influence on the quantity of money in an upward direction. It makes little difference whether business firms sell government securities, their own securities, or borrow directly from banks to finance an expansion in their operations. The amount of these securities absorbed by the banking system will depend on the reserve position of the banks and their desire for liquidity, as it always has. Consequently, an expansion in the money supply can only be checked by limitation of bank reserves (with given desires for liquidity), or by limitation of the "needs of business" through direct controls.

Moreover, the supposed passiveness of the banking system in the past to the needs of business is in part fictitious, as Professor Whittlesey himself admits. Although there is a strong tendency for the amount of deposits and currency, particularly the latter, to follow changes in the needs of business, it is possible that the needs of business are themselves strongly influenced by monetary factors. Particularly in New York City—the nerve center of the security markets and the banking system—cyclical fluctuations in bank deposits and reserves have generally shown a substantial lead in time over cyclical fluctuations in the volume and value of transactions, prices of common stocks, or of any other series of economic data for that matter—a fact which is rather difficult to reconcile with the automaticity theory.

I have indicated some of the reasons why I am not so pessimistic as Professor Whittesley and Dr. Bopp about the fruitfulness of a policy which relies upon changes in the quantity of money to effect desired changes in the flow of expenditures. It seems to me that we must rely primarily on such a policy to control the business cycle if at the same time we are to retain the essential elements of private enterprise.

Lawrence H. Seltzer: The significance for monetary theory and policy of the appearance and persistence of large amounts of excess reserves in our banking system in recent years lends itself easily to exaggeration.

For Professor Whittlesey, this development seriously challenges traditional concepts, and for some others and perhaps for him, it has raised grave doubts about the technical ability of the central banking authorities to influence the volume of member bank credit by alterations in the latter's reserves.

The gist of these comments is that, in my opinion, such views are based upon an unduly mechanical interpretation of the historical facts and of bank-

ing theory, but that recent developments, which have transformed the whole practical problem, will render the over-all curtailment of member bank reserves through Reserve bank action difficult and dangerous in the near future, and will render the maintenance of nominally excess reserves or their equivalent desirable and probable.

A substantial amount of reserves in excess of member bank statutory requirements first appeared on the American banking scene soon after the banking collapse of 1933. That collapse had scared the daylights out of American bankers, and it should surprise no one that they thought it advisable for a time to carry some reserves in excess of the legal minima. Then, in 1934, following the 41 per cent reduction in the gold content of the dollar, there began that great torrent of gold imports which, in conjunction with production and the higher price of gold, expanded our monetary gold stock from 4 billion dollars at the end of 1933 to nearly 23 billions at the end of 1941.

Now, under the conditions then prevailing, how fast and how fully should the member banks have utilized the additional reserves created by these gold imports, to approximate reasonable expectations? The mechanical obstacles alone would surely prevent anything like instantaneous and complete utilization, for the amounts were unprecedentedly large. The total reserve balances of the member banks increased by 142 per cent in the three years 1934-36, inclusive, and more than doubled again in the next four years. After allowing for the enlargement of legal reserve requirements by reason both of the expansion of deposits and the administrative increases by the Board of Governors in the required proportions, the remaining additions were so sizable that even under favorable conditions the process of "residualizing" them would be expected to take time, during which excess reserves would remain large. Under these circumstances, this fact would not be in conflict with reasonable expectations based on traditional theory.

In addition, a number of special influences were operating to slow the use of excess reserves and to convert part of what were technically excess reserves into needed reserves. Let me recall some of these:

First, it was well known that substantial amounts of the additions to bank reserves were arising out of imports of short-term banking funds which, particularly at first, could not be counted on to stay.

Second, the call loan market had shrunk to small proportions, and significant amounts of open-market commercial paper and customer loans were simply not available. Apart from a relatively small amount of Treasury bills, this left the bond market, and particularly government securities, as the only important outlet for free reserves, and bonds do not constitute the best secondary reserves.

Moreover, our bankers, traditionally, have been specialists in direct loans, not students of the bond market. The internal organization of most of our banks is designed primarily for the analysis and supervision of local credits, not for the investigation of marketable securities. Further, unlike the direct loan, which has no market price in the usual sense, the bankers were uncomfortably aware that their investment securities, even when confined to the highest grade, were subject to unpredictable price changes. For these rea-

sons, bankers were naturally more reluctant and slower to utilize their new reserves for the purchase of securities than they would have been for commercial and other short-term paper.

Third, in view of their very thin capital equities, their new dependence upon marketable investments, their relatively small holdings of Treasury bills, and the great scarcity of all other sources of good secondary reserves, most bankers deemed it imperative to maintain an unusually large proportion of their total assets in cash. In other words, these conditions dictated effective reserve requirements that were higher than the legal minima.

Finally, the continuous political unsettlement abroad, widespread unemployment at home, and the caution engendered by the financial collapse of the early thirties, operated in the same direction.

In the face of these restraining influences, the actual amount of member bank credit expansion was very substantial, even before the beginning of our defense program and our entrance into the war. The illusion that the banks made little use of their excess reserves arises out of looking only at the amounts of excess reserves, which were being swelled by fresh gold imports as fast as or faster than they could be used, and ignoring the movements of total earning assets. The member banks increased their loans and investments by 8 billion dollars in the three years ended December 31, 1936—an increase of about 32 per cent, and nearly all of the increase was in government securities. The combination of a bad scare in the government bond market in 1937, during which the member banks reduced their holdings of "governments," and industrial depression in 1938, then caused a reduction in their earning assets despite large further additions to their free reserves. But a high rate of credit expansion was resumed in 1939, and was enormously accelerated subsequently by the defense program and our participation in the war, for these led to the creation of large additional amounts of customer loans and short-term Treasury paper, and they were accompanied by official assurances and policies that greatly reduced the risks of bank-buying of government securities.

In the two years that have elapsed since Pearl Harbor the member banks have used up in credit expansion all their previously existing excess reserves, which had amounted to nearly 4 billion dollars early in December, 1941, and in addition, they have used up nearly 3 billions more derived from the abolition of reserve requirements against war loan deposits and reductions in the required reserve ratios for member banks in New York City and Chicago. (Drains on reserves caused by increases in the amount of currency in circulation, gold exports and other factors, have been nearly but not entirely made up by increases in the amount of Federal Reserve credit outstanding—mainly holdings of government securities—and by increases in Treasury currency outstanding.) The 1 billion dollars of excess reserves that now remains may be disregarded for practical purposes, for it is held mainly by banks outside of the money centers that do not regard the amount as unused lending power but as necessary reserves.

Reviewing what has happened, I do not find that it has been significantly at variance with the common view that commercial banks will be moved by

ordinary motives of profit to reduce their reserves to the minima required by law, custom, and considerations of individual safety and convenience. It should be a commonplace, however, that the effective reserve requirements so arrived at may at times be greater than the legal minima; and that time is needed to assimilate large changes.

The simplified accounts found in some writings of the prompt and quantitatively precise effects of changes in bank reserves should mislead no one. Like other scientific statements, they are or tend to be true only under certain expressed or implicit assumptions. Among these are the absence of outside influences that partly offset or entirely overwhelm the effects of changes in reserves, the absence of previously-created slack in reserves, and moderateness in the scale of the changes.

The stability and uniformity of reserve ratios which Professor Whittlesey holds vital both to theory and, implicitly, to effective public policy, have not actually prevailed—in either England or the United States. In England, it was not until after the first World War, and largely through consolidations, that the banks came to observe the so-called "customary" reserve ratios with any steady consistency as between themselves or over extended periods of time; and even in very recent years I have read complaints in British financial publications from time to time to the effect that a scarcity of Treasury bills was preventing the banks from fully utilizing their cash reserves because they desired to maintain a certain minimum proportion of highly liquid assets as a whole, as well as a minimum proportion of cash.[1] In our own country, large amounts of excess reserves in a legal sense appeared at various times during the half-century preceding the establishment of the Federal Reserve System.[2]

Such departures from simplified textbook models offer no insuperable difficulty to banking theory when they are susceptible of rational explanation, but rather serve to promote a richer, more adequate theory.

Nor do they vitally impair the reasonable possibilities of central banking as an instrument of public policy. Quantitative control of member bank reserves has always been a blunt and limited instrument, capable of moving in a desired general direction, but without certainty, precision, or discrimination. The basic reason for the uncertainty of its influence on the general course of affairs is that the banking system is only a part of the whole economic environment. Droughts, earthquakes, wars, and internal political changes, among other forces, may for considerable periods dwarf the influence of the monetary-banking mechanism upon the course of prices, the volume of employment, and the level of the national income. The limitations upon the power of the Federal Reserve authorities do not arise from the inadequacy of their control over the member banks, but from the varying, uncertain, and at times highly restricted influence of the whole banking system upon the spending and investment activity of the public.

This is most conspicuous, of course, in connection with expansionary efforts. In these it is notably easier for the Reserve authorities to influence the mem-

[1] Cf., for example, *Midland Bank Review*, Feb.-Mar., 1939, pp. 2-7.

[2] Cf., *Senate Document* 509, Plate No. 22, 61st Congress, second session, Washington, 1910.

ber banks than for the banks to influence the public. Through the provision of sufficient excess reserves—a greater amount may be required under some conditions than under others—the member banks may be induced to seek additional earning assets. But more lenient credit standards and lower interest charges on their part may not suffice to make significant amounts of new loans and investments available to them. The banks will nevertheless tend to add to their holdings by bidding away outstanding securities from non-banking holders, and refinancing loans held by others. But although the amount of the public's bank deposits will be increased through this process, there is no assurance that the new money will be spent; that is, used to increase the demand for the current output of goods and services. The additional deposits may merely be hoarded—held as substitute investments by those who sold securities to the banks. It is this feeble control over the activity of the public's money rather than the absence of mechanically-precise responsiveness of member banks to alterations in their reserves that imposes the most important limitations upon central banking policy.

The technical condition of member bank reserves, moreover, is only a part of the whole banking situation at any time. Hence, the ability and disposition of the member banks to expand or contract their credit cannot be measured mechanically by their technical reserve condition alone. Effective reserve requirements, as I have noted, may be greater than the legal minima—by reason, for example, of a shortage in good secondary reserves. Further, bankers anticipate the trend, as well as respond to the immediate fact, of official policy; and they are susceptible to warnings and to moral suasion. For these reasons, the possession of technically excess reserves does not insulate the member banks from restrictive or expansionary policies of the Federal Reserve authorities.

Two recent instances are illustrative in this connection. Early in 1937, the Reserve Board announced an increase of one-third in the minimum reserve requirements of member banks, and the Treasury at this time was following the policy of preventing new acquisitions of gold from increasing member bank reserves. The Treasury did this by borrowing the amounts needed to purchase incoming gold and failing to reimburse itself through the issue of gold certificates for the gold. Although other influences doubtless contributed to the result, it is significant that in the face of (statutory) excess reserves that at no time fell as low as 700 million dollars, the member banks during 1937 reduced their holdings of government securities on a declining bond market by about 2 billion dollars and reduced their loans as well.

The current expansion of member bank credit provides a complementary illustration of the same principle, for in this case *effective* reserve requirements have been radically reduced and credit expansion stimulated by policies other than changes in legal reserve requirements. These policies—substitutes for excess reserves—have been: (1) the repeated official announcements of the intention of the Treasury and Federal Reserve authorities to maintain the existing pattern of interest rates during the war—announcements which provide implicit assurance that the member banks will be provided with any additional amounts of reserves that they may require; (2) the establishment

and maintenance of a posted buying rate for Treasury bills, a policy which transforms the bill portfolios of the member banks into the equivalent of additional reserves, so far as any individual bank is concerned, making it possible for the bank to obtain actual additions to its reserves at will without borrowing; (3) the offering of very large amounts of Treasury bills and other short-term securities by the Treasury for bank subscription, which made large increases in banking holdings of government securities compatible with the maintenance of a high degree of liquidity by the individual bank; and (4) the announced readiness of the Reserve banks to value all government securities at not less than par when offered as collateral for advances to member banks.

These four policies made it possible for the member banks to look with equanimity upon the decline in the level of their excess reserves. But if and when the time comes to abridge, reduce, or eliminate these assurances of unlimited additional reserves as needed, the restrictive effects upon the member banks will be like those of a reduction in actual reserves; and, in some circumstances, the effect will be to lead the banks again to desire a cushion of excess reserves in the statutory sense.

I said at the outset that the problem of excess reserves has been entirely transformed by recent developments. The excess reserves of the thirties were only potential bank deposits. Now, what was previously potential has become actual.

In a mechanical sense the Reserve authorities are now in a better position to employ over-all alterations in member bank reserves as an instrument of policy, for little slack remains in member bank reserves. Indeed, the existence of war loan deposits puts the member banks in debt to the Reserve banks, in a sense, for as these deposits are spent by the Treasury they are transformed into ordinary demand deposits against which the member banks will be forced to find and carry additional reserves. But the greatly enlarged volume of the public's bank deposits and currency is surely less sensitive to the Reserve Board's desires than were the excess reserves used up in creating these deposits.

Moreover, in the situation that is now unfolding, the Reserve authorities may well be expected to hesitate to curtail the over-all volume of member bank reserves even if they are convinced that the present quantity of deposits is excessive. In most previous periods of great deposit expansion, the deposits arose out of business loans. A curtailment of bank reserves would force the banks to call or to refuse to renew some of these loans. And the repayment of the loans—from the proceeds of inventory and other liquidation—would destroy a corresponding amount of deposits. But government securities now constitute the principal source of existing deposits, and, for practical purposes, they are the only assets which the banks would be likely to dispose of in substantial quantities if forced to contract their credit. In other words, the volume of deposits cannot be substantially cut except by a reduction in bank holdings of government securities. Such a reduction could come about only through the retirement of bank-held public debt securities by the Treasury or through the sale of bank holdings to the public. The ability of the Treasury

to retire debt in the near-term future will be the product of many factors beyond the control of the banks and the Reserve authorities. In particular, it will be the product of Congressional tax measures, Congressional appropriations, and the national income.

The Treasury could, of course, refinance bank-held debt with new securities sold to the public, and a large-scale funding loan of this character would be in the classic tradition. Its proper purpose would not be the traditional one of funding the floating debt in order to relieve the Treasury's uncertainties. Its purpose would be the monetary one of reducing the volume of money in order to prevent or check an excessive rate of aggregate spending—excessive being indicated by rising prices. One special advantage that the Treasury would possess over the banking authorities in this connection would be its power to design types of securities newly and specially adapted to appeal to important classes of investors. Note that this monetary power resides in the Treasury, not in the Federal Reserve System; and that the monetary effects of a budgetary surplus are called into being by Congress.

In the absence of an aggressive funding operation by the Treasury, which could be expected to tap wider sources of funds than are ordinarily available to the bond market, substantial transfers of securities from the banks to the public—say 10 billion dollars or more—could scarcely be effected in a short period of time without a sharp decline in bond prices and a corresponding sharp rise in interest rates. No one knows just how responsive the nonbank demand for government securities would be to declining prices and rising yields. Hence there is no certainty that forced selling by banks would effect more than moderate transfers of bank-held securities to the public. The banks might well find themselves offering securities mainly to one another at declining prices.

The effectiveness of an over-all restrictive reserve policy in these circumstances would then be derived from its wide psychological repercussions. These are not calculable in advance and might be more violent than was contemplated or desired; and fear of this result may be expected to discourage the use of over-all quantitative restriction of reserves.[3] The immediate and prospective effects upon the Treasury's interests costs, in the light of the large amount of its short-term debt, and upon the asset position of the member banks, would likewise exercise a powerful deterrent influence upon the Reserve authorities.

In addition, however excessive the aggregate volume of deposits may be, legitimate demands for direct or indirect extensions of bank credit to business are likely to be made in substantial amounts in the early postwar period. Many business concerns will wish to sell their holdings of government securities acquired during the war, or let their short-term holdings mature, in order to use the proceeds to replenish their inventories, rearrange and expand their

[3] The difference between this uncertainty under prevailing conditions and under those that formerly existed should not be exaggerated, however. In former times, also, the psychological repercussions were important and incalculable. But a surer market existed for loans and discounts than exists for government securities because the business borrowers provided the market for their own bank loans.

facilities, etc. Banks may be the only ready buyers of such securities when they come on the market either from the business enterprises directly or through Treasury refinancing. Equally legitimate demands will be made by business enterprises that desire access to bank credit directly, through loans. The satisfaction of such legitimate demands for bank credit, while adding to the aggregate volume of banking deposits, cannot be usefully denied because credit extension would in these cases contribute powerfully to the anti-inflationary forces by facilitating the expansion of output.

These considerations suggest that the Reserve authorities will hesitate to lean heavily upon over-all quantitative restriction of member bank reserves as an anti-inflation weapon; that they may well have to provide liberal additional reserves; that they will attempt to use qualitative controls and moral suasion in place of over-all quantitative controls as much as possible—though without assurance that the substitutes will be adequately effective; and that Treasury borrowing policies and Congressional budget policies will inevitably play an important role in postwar monetary policy.

# SYMPOSIUM

BY

PAST PRESIDENTS OF THE AMERICAN ECONOMIC ASSOCIATION ON THE TOPIC:

# WHAT SHOULD BE THE RELATIVE SPHERES OF PRIVATE BUSINESS AND GOVERNMENT IN OUR POSTWAR AMERICAN ECONOMY?

*Introductory Remarks* by JAMES WASHINGTON BELL, Chairman: In making up the program this year, the perennial question of the relation between government and private enterprise again came up for consideration as an appropriate subject for papers and discussion.

The relative sphere of government activity in our economy has increased so sharply during the past generation that some persons whose experience and views are limited to the events of current history believe that this problem is of recent origin. The relation of government to business is, however, not only a contemporary matter. All formally trained economists have come into contact with the issue of government versus private enterprise at some stage of their careers regardless of their field of study and investigation.

It occurred to some of us that a sense of perspective or proportion might be obtained in the statement of the general problem if we should draw upon the accumulated experience and ripe judgment of the living past presidents of the Association. This symposium or panel discussion is a materialization of that idea.

The symposium is designed to serve yet another purpose; namely, to bring together on the platform as many of the twenty-one living past presidents as could attend these meetings so as to afford our members and guests an opportunity to hear these eminent economists speak briefly on a subject of vital importance and of general interest. The subject selected we hope will give each participant an opportunity to contribute some typical or characteristic point of view, possibly reflecting his field of specialization.

In sending out invitations, the wording of the question was as follows: Full employment and economic stability being taken as necessary basic conditions to national prosperity, what should be the relative spheres of private enterprise and of government in our postwar American economy? Some exception was taken to the wording of the topic, particularly to the terms: full employment, which could be interpreted to mean that everybody should be guaranteed a job—admittedly a dangerous doctrine; economic stability, which was called "a modern catchword"; and prosperity, which was questioned as the paramount deciding factor. Again, some stated that a 500-word limitation permits the expression of only vague platitudes. The participants were informed that it was not the purpose of the Program Committee to solicit a "yes" or "no" answer, that we all realize the shortcomings of the symposium as a scientific device, and that there would be no objection to a change in the wording of the question, nor to the limitation of treatment to one or two phases which by implication might suggest or give a clue to the individual's position on related aspects.

Statements were read by those who were present; others, unable to attend, submitted their contributions; and in three instances no formal statements were sent but excerpts from letters have been included in the following summary.

NOTE: The number preceding the names of the participants indicates the order of their incumbency as president of the Association; and the numbers following in parentheses refer to the fields of specialization of these persons as they appear in the classified *1942 Directory*. (See also 1943 supplement tipped in this volume for identification of fields.)

*Statements by Past Presidents*

14. Frank A. Fetter (1, 12, 8): What is here demanded, as I understand the question, is a cure for the two most threatening diseases of capitalism: (1) the business cycle, which disrupts periodically the time relations of successive price systems; and (2) the continued disequilibrium between particular profits, wages, and employment in different parts of the price system in what are called normal times.

We assume without argument that the cause of the upswing in the business cycle is the excessive use of credit, not the use of money per se. All financial booms have the essential character of the Dutch tulip mania. Capital values are based on the hope of the further rise of capital values, not on a reasonable estimate of the future earning power of the productive agents purchasable with the capital. Capital values thus feed upon themselves. For a time capital gains exceed interest charges, and the volume of credit multiplies. When this ceases to be the case, inflated capital values collapse. The evils of the succeeding depression period are due primarily to the existing volume of debt and fixed charges expressed in monetary terms. If all exchanges were effected by cash, if there were no deferred payments, there would be neither great periodic tidal upward movements of capital values, nor periodic collapses of production and employment.

If this is a true diagnosis, certain measures of prevention are plainly indicated, such as: limitation of the right to create private debt; confinement of long-term corporate investment to equities; strict control of marginal and installment buying; restriction of commercial banking to the legitimate function of seasonal credit; and other measures to prevent the perodic wholesale overextension of credit and the creation of debt.

This, however, would not fully solve the problem of unemployment. There is another kind and cause of unemployment having a chronic rather than intermittent character. Frequently after a boom some commodity prices and wages remain at high levels when prices pretty generally have fallen—an almost certain evidence of capitalistic or of labor monopoly. It is axiomatic that to stabilize particular prices in this way (that is, forcibly to keep them high relative to other prices) is to unstabilize, that is, *reduce,* production; and to stabilize wages in this way is to reduce employment. Those workers who are so fortunate as to remain employed at their former wages when most prices have fallen, enjoy greater real incomes than ever before, to the disadvantage of the unemployed and of the whole community.

Such forced "stability" of particular prices and wages tending to prevent full employment and to aggravate disequilibrium in the whole price system, calls for the suppression of monopoly, whether of capital or of labor. Antitrust laws should be strengthened and enforced; financial combinations weakening potential competition should be dissolved; local discrimination—the chief offensive weapon of capitalistic monopoly—should be ended. The extra-legal control of organized labor over the most fundamental of political rights should be replaced by public tribunals ensuring the peaceable adjudication of industrial disputes.

The proper spheres of government and of private enterprise in such a program are almost self-defining. It is the part of government to enact the appropriate economic legislation and to adjudicate and administer it vigilantly; this is anything but laissez faire. The part of private citizens is to earn their livings within the framework of a truly free enterprise system, and to support the government.

The nation as a whole would, of course, be glad to secure economic stability and full employment if it could get this as a free gift. But is the nation ready to make the resolute effort necessary to overcome the opposition of those interested in maintaining the present evils? Is our political virtue equal to our economic knowledge? That is not yet clear.

17. Walter F. Willcox (4, 20): I believe (1) that no principles can now be formulated about "the relative spheres of private enterprise and of government in our postwar American economy" and (2) that those spheres will be adjusted and readjusted in conformity with the results of experience and the reactions of public opinion to those results.

18. Thomas N. Carver (1, 15, 3): When government starts producing something which private enterprise is already producing, the public gets no new product or service and workers get no new jobs. But when government starts doing something useful which private enterprise cannot do, there is a new product or service and some new jobs. The first intelligent step, therefore, in postwar planning must be to locate the line which separates the fields for the two kinds of enterprise. In separate fields they supplement each other; in the same field they compete.

Anything which consumers will buy at a price which will cover its cost can be produced and distributed by private enterprise. Some things cannot be thus sold and must be paid for, if at all, by taxation. If such things are really worth what they cost they add to the wealth or well-being of the country and to its ability to pay taxes. This indicates the logical line of demarcation between the two fields.

Lavish expenditure of tax money for useless things does not add, even temporarily, to the employment of labor. Every dollar thus spent by government comes out of the pocket of some taxpayer and reduces his purchasing power as much as it increases the government's. It may be claimed that such a transfer of purchasing power increases the velocity with which money circulates, but the chances are that it will do the opposite. Every taxpayer must accumulate his tax money, and it is inactive while it is accumulating.

The only way by which a program of lavish government spending can add,

even temporarily, to the sum total of spending is to inflate the currency. By injecting new currency into circulation, the government can leave private spenders with all their spending money, and itself spend new money; but inflating the currency has its dangers and penalties. Currency inflation is not only dangerous, but, as a long-run policy, absolutely futile. In order to be effective, currency inflation must be continuous. The currency cannot merely stay inflated without a collapse. When the government stops injecting new currency into circulation, then every dollar which it spends comes out of the pocket of some taxpayer or some lender. The only relief, even of a temporary sort, given by the stupendous spending program of the thirties was the result of inflationary borrowing.

It is only through the expansion of those enterprises, private and public, that produce enough to cover the cost that employment can increase. In the field of private enterprise, there is no a priori reason why industry, rather than agriculture, the professions, or domestic service should be blamed for unemployment. The practical reason is that new products called for by a rising standard of living are the products of mechanical industry.

19. JOHN R. COMMONS (17, 1, 10): I favor private enterprise, meaning corporations, cartels, labor unions, political parties. But private enterprise means, also, extremes of unemployment and depression, alternating with full employment. Hence I favor public control and prevention, especially control of credit and banking, to stabilize prices; also public ownership of basic enterprises and prevention of unreasonable monopolies.

20. IRVING FISHER (1, 7, 4, 6): I feel strongly that "full employment and economic stability," together with maximum national income and its best practicable distribution, will depend greatly on a wise utilization both of private enterprise and of government co-operation.

As I see the present situation, there are six supremely important problems needing solution; namely, the problems of (1) world peace, (2) foreign trade, (3) migration, (4) stable money, (5) taxation, (6) industrial relations.

On all these problems except migration I am on record in various writings, including books on three of them—world peace, stable money, and taxation. This fact may serve as excuse for some brevity and dogmatism here.

1. I have come to believe that an enduring world peace can be secured by, and only by, a world government. While not fully satisfied with any plan, Culbertson's seems the best to start with.

2. I believe that substantially free trade in commodities would benefit us, together with the rest of the world.

3. I do not believe in free immigration. In America the best approach to a solution of the insoluble problem of postwar migration seems to me to be a continuance of the present quota system (opened up, of course, to China but not Japan—for the present). [Since this was written it *has* been opened up to China.]

4. With some reservations, I like the White money plan, and, still better, Lord Keynes's money plan, as far as they go, but believe we need some provisions in addition (especially the ancient system of a 100 per cent reserve

behind checking deposits; gold may be retained, provided its price is made adjustable properly).

5. I believe the most important tax reform would be to untax savings. By savings I mean capital-increase. Corporations should have no income tax, except for stoppage at the source on behalf of stockholders, as in England.

Our present system of taxing savings (especially corporation undistributed profits ploughed back) threatens to destroy our system of private enterprise and to substitute state socialism. Undoubtedly some friends of our present outrageous tax system are aware of this and are trying to "put over" state socialism, catching our country unawares, through the tax system.

I am, however, in sympathy with the idea of heavy taxation on estates and inheritances, to avoid hereditary plutocracy and its consequences, especially its social consequences.

6. I believe that industrial output and real wages can be greatly increased in peacetime by making labor and management feel emotionally that they are genuine friends, not enemies. Nonmonetary incentives to work are, I believe, as important as monetary. This has been well demonstrated by Robert D. Wolf, now with Weyerhaeuser. The Jack and Heinz Corporation in Cleveland also seems to be among the foremost in applying this idea.

This last in the above list requires, as the chief factor, the private initiative of management, with re-education of both management and labor.

All the other five reforms are predominantly matters of government. But to secure any of them will, in our democracy, require great changes in public opinion. A wise attitude of what we call "business" is essential.

I am much in favor of retaining our American system of private enterprise. But it is now in jeopardy, largely because so few businessmen know what they want or are ready to fight for it.

I believe government, especially in America, is ill-fitted to take the place of private enterprise. I would have the government withdraw from business and from loan-banking. But government alone can and should control, regulate, and stabilize the money supply. That is, it should supply business with a stable dollar just as it supplies business with a stable yardstick. It also can act as a stabilizer through public works and insurance. It can also function in research and as a source of information.

I am, in short, in favor of having the government do what it seems to me it can do best and refrain from doing what it seems to me private enterprise can do best.

26. Wesley C. Mitchell (5, 4, 10, 1): I am not able to answer the question put to past presidents of the Association; but I venture to suggest an approach that may be helpful to some of the many economists who in years to come will be dealing with particular cases of the general problem.

The criterion to be applied in trying to decide whether a given activity should be entrusted to private or to public agencies is: Which form of organization will better promote the common welfare? In accepting this criterion, as I suppose all of us do, we are laying the basis for value judgments; that is, we are entering the proverbial realm of endless disputing. Just because disputes about what we like are endless, every nation has to have some crude practical way of deciding disputes that affect common

interests. The democratic way is to let everyone choose for himself when serious conflicts do not arise, and to accept majority rule when they do.

In the mind of a citizen, different national aims compete for favor, much as his individual wants compete for satisfaction. The weighing of alternatives is deliberate and intelligent in some minds, casual and stupid or even subconscious in others. Upon this process hang the ultimate policy decisions of a democracy. One who hopes to influence such decisions needs to learn all he can about the underlying valuations, how they are made, and how they can be modified. Whatever economists say in their treatises, they cannot in practice dispense with a theory of valuation.

The present war demonstrates that a large majority of Americans put the preservation of their liberties highest in the scale of values. To it they are sacrificing their lives by the thousand and their wealth by the billion. They are using their common agency, the federal government, to organize their vast and costly effort. Superficially, the compulsions they impose on themselves may seem inconsistent with their professions. Rightly viewed, they are consciously and voluntarily restricting their personal liberties "for the duration" in order that they and their children may enjoy these liberties in a very long run.

Whenever a freedom-loving people uses the authority of their government to control certain activities, they are restricting their individual liberties. World War II is merely the most extreme case of such action in American history up to date. Laws providing for compulsory education, social insurance, sanitary measures, the fencing of dangerous machinery, supervision of public utilities, the protection of home industry, the imposition of taxes, and so on without end, are milder cases of the same type. Every proposal for enlarging the relative sphere of government poses a problem in valuation, to solve which intelligently we must weigh both sacrifices of personal liberties and possible gains in welfare, material and cultural.

Economists should contribute what they can toward making these evaluations intelligent. No science tells what we like and what we dislike, or what is good and what bad; but the sciences help us to decide these fundamental issues by showing the probable consequences of alternative courses more fully and more reliably than does common sense. Economists are specially equipped to trace consequences of only one type. Most, if not all, proposals for altering the relative spheres of private business and government have repercussions of a political, sociological, educational, psychological, or physiological sort on human beings, and many affect also the physical environment. Hence numerous sciences can contribute toward intelligent social valuations, and one of the improvements in practice for which we may hope is better teamwork among their representatives. Economists should set a good example by never talking as if their advice is all that needs to be taken.

Before giving his own bit of advice, an economist should make sure that his forecast of probable consequences applies to the actual conditions under which an issue arises—not merely to some simplified set of conditions he has assumed as a basis for reasoning. Actual conditions are never "static," but always subject to change. Also, practical problems always involve quantitative

as well as qualitative analysis. Economics becomes indeed "a serious subject" when it is used responsibly as a basis for advising about common welfare.

28. EDWIN W. KEMMERER (7, 6): The maximum of enduring public welfare, which should be the goal of our postwar American economy, demands the largest possible production and the most equitable possible distribution of goods and services of high and continually improving quality. Not only should there be a generous supply of such commodities, but hours of labor and conditions of labor should be reasonable, and there should be sufficient leisure to permit proper enjoyment of the economic goods produced.

Human wants are unlimited when quantity, quality, and variety of goods are all taken into consideration; so, likewise, are economic frontiers of production, both extensive and intensive. Therefore, we shall never have a general overproduction of goods.

A sound economy calls for imagination, initiative and drive on the part of producers, and for a milieu of law and order in which to work. In the long run the game must be played fairly if it is to be played well. This requires the formulation and enforcement of reasonable "rules of the game." It also requires adequate rewards for the players—rewards which, with due allowance for the risks and hardships involved, shall be roughly proportional to their achievements. It furthermore demands the imposition of adequate penalties upon all who refuse to play the game according to the rules.

Broadly speaking, and allowing for exceptions, particularly in the fields of natural monopoly, industrial monopoly, and public utilities, the economic game should be played by private enterprise.

Since initiative, risk-taking, experimentation, and pioneering are the springs that put the drive into the economic machine and keep it moving forward, and since they operate most effectively in an atmosphere of freedom, governmental restrictions and controls should be kept at a minimum. The presumption should always be against them. Here the supreme test is experience. This is sound philosophy anywhere, it is pre-eminently sound in a country like the United States, rich in undeveloped resources, strongly imbued with the pioneer spirit, and blessed with the tradition of Anglo-Saxon freedom.

Taking human nature as it is and politics as they are, there is a great danger that governments, in the struggle for perpetuating and increasing their power, will stifle initiative and retard progress. Every student of government and business knows that there is reality under such commonplace phrases as government smugness, playing politics, political pull, official red tape, and the tyranny of petty officials. Our literature is full of references to such weaknesses in government. "Men moving only in an official circle," said Abraham Lincoln, "are apt to become merely official—not to say arbitrary in their ideas." Speaking of politics Ralph Waldo Emerson said, "The teaching of politics is that the Government which was set for protection and comfort of all good citizens, becomes the principal obstruction and nuisance with which we have to contend. The cheat and bully and malefactor we meet everywhere in the Government." Along the same lines Havelock Ellis said: "The impulse to meddle is usually in inverse ratio to experience, tolerance and breadth of mind." These evils are worse in some branches of government than in others

and at some times than at others. Doubtless they all have their counterparts in private enterprise. But here they play a much less important role than in government service.

We must have order as well as progress, but we must be continually on our guard that the controls we impose in the interest of order do not retard progress.

When, after full study, the public decides that the government can do a particular economic job better than private enterprise and the government therefore takes over the job, it should subject itself to the same laws, the same publicity, and the same rules of economic fair play that it imposes, or has been imposing, on similar private enterprise. If it cannot compete with private enterprise on equal terms it should give the job back.

The government should set for itself and should require of private enterprise, including trade unions, employers' organizations, and other groups of producers, adequate systems of accounting and a very high degree of publicity of their accounts. This should be done with the object of keeping the public well informed concerning the nation's economic activities.

In general, so far as concerns the field of business, the efforts of government should be directed more to the diffusion of economic light and less to the generation of political heat; more to laying down and enforcing fair rules of the game for private enterprise and less to the government's playing the game itself and to giving meticulous instructions to others as to how they shall play.

31. Edwin F. Gay (2): I do not like the formulation of the question. "Full employment and stability" are the modern catchwords. They are of course desirable, but are nowadays overemphasized, to the diminution of risk-taking enterprise. The sphere of government has increased during the last two generations, is vastly increasing, and despite postwar probable reaction, will in the net increase, but its every advance should in my opinion be challenged and made to prove its necessity.

33. Ernest L. Bogart (2, 6, 10): If full employment is to be found in productive enterprise after the war, it must be through the expansion of private business to a point considerably above that attained in any prewar year. In the transition period of reconversion from war to peacetime production, direct government enterprise in the form of public works and similar undertakings will undoubtedly be needed, as well as financial assistance to some private enterprises. But this should cease when the transition period ends. Equally important will be the refraining on the part of government from doing positively harmful things, such as pursuing an inflationary policy.

As I see it, the postwar American economy will be different from that which prevailed before the two world wars. Capitalism of unrestrained laissez faire—if there ever was such a thing—is today an anachronism. Government must be accepted as a partner in private enterprise, and its helpful co-operation regarded as a normal procedure. But this does not imply government ownership or management of productive undertakings. Rather, it means the creation of a favorable economic climate for the furtherance of private enterprise on an expanded scale.

According to the last census there are some 2,100,000 private business employers in the United States, exclusive of agriculture. Of these some 400,000 employ more than 8 persons each and 3,300 employ 1,000 or more workers. Current estimates state that, in order to attain full employment after the war, it will be necessary to increase our national income by at least one-third. It is scarcely credible that big business alone will be able to expand its operations sufficiently to achieve this result. Reliance must be placed upon the 1,600,000 small employers, with one to eight workers each, to meet the changed situation. Much has been learned during the present war, through experience with subcontracting and in other ways, as to the resourcefulness and productive capacity of these privates in the industrial army. Whether as partners or as independent producers, their contribution will be needed in a postwar world. The final outcome should be not only a changed attitude on the part of business to government and of government to business but also greater co-operation and less fear between big business and small enterprises.

To sum up, the role of private enterprise in our postwar American economy will be—should be—to carry on productive industry, to expand production, and to ensure, so far as may be possible, full employment to those able and willing to work. The role of government will be—should be—that of regulation, either by helping or discouraging, with a view to promoting sound business practices and preventing speculative and inflationary movements. The role of government will be both more important and more powerful, but this should strengthen rather than weaken the system of private enterprise, to which, in the last analysis, we pin our faith.

37. John M. Clark (1, 10, 5): The dominance of the problem of abundant and stable employment, in a setting of problems of war, peace, and international organization, necessitates nothing short of a revolution in the nineteenth century concept of the state and of private economic ethics. The state was a policeman, telling people what they must not do; and economic ethics consisted mainly of a simple and rather negative code of common honesty. The state is a restraining agency: it has hardly begun to learn how abundant peacetime production may be activated. The economy which has to be activated is increasingly made up of group organizations, possessing a considerable degree of monopoly power and political representation. This alone would render obsolete that part of the nineteenth century theory which sanctions fairly irresponsible self-interest within the limits which the policeman-state allows. These organized groups are themselves forms of government, and must sooner or later accept the responsibilities that go with this. Beginnings have been made during the war, but more is needed—preferably before irreparable damage is done.

Literally full and completely stable employment can be actually assured only by an outright collectivist system. The majority—including, I believe the majority of organized labor—does not want this, but is likely to get it by default. If this outcome is to be avoided, serious consideration must be given to the conditions necessary to enable a more voluntary system to survive, and to perform sufficiently well. Obstacles must be removed as well as motive

force strengthened. One primary obstacle is an attitude of suspicion between groups.

For the state, the first fact is that, while restraint is a piecemeal matter of dealing with specific abuses, stimulation of the economy is an organic whole, and requires a government capable of a unified economic policy. This we do not now have. It requires reconstitution of the executive, of the organization of Congress and of the liaison between them. Next comes a canvass of the aggregate impact on enterprise of the piecemeal structure of regulations and taxes, with a view to removal of avoidable obstructions. In the meantime, there must be considerable regulatory spending, and probably increased subsidizing of private consumption. But public spending alone, while necessary, is a makeshift, and needs to be accompanied by serious examination of more imaginative proposals bearing on the balance of savings and investment, directly or indirectly, and not necessarily confined to raising offsetting expenditures up to potential savings under conventional mores of providing for future individual needs. Effective combating of monopolistic restrictions in the sale of labor as well as of commodities, continues to be necessary, though not sufficient, and should emphasize those which act as a bar to plentiful employment. It should be accompanied by positive measures to strengthen the ability of small business to compete efficiently, and it needs to be accepted in principle by all major groups.

But the government cannot do it all. Abundant employment is everybody's job. Distribution of benefits must be conditioned on acceptance of responsibilities; including the responsibility of setting up a wage-price structure favorable to expansion rather than restriction and of getting together in positive plans which place expanded physical production and total real pay rolls ahead of profits and high hourly wage rates. I believe that business needs to be so organized that it can adjust itself to a lower rate of profit than is now considered reasonable, on an increased volume of sales and investment; and also that the method of paying wages needs to be altered so that marginal product shall not be unduly loaded with marginal wage-costs. To illustrate by opposites, the government cannot afford to guarantee the construction industry full employment, via public works, if in that industry there is output-restriction and cost inflation.

What I am advocating is really a far-reaching evolutionary change in economic institutions and relationships, with no definable terminus, involving the adjustment of what are now considered rights and the acceptance of unaccustomed responsibilities in order that more important rights may be furthered. It requires that people, and their economic organs, develop an attitude of reasonable collaboration before it is too late. If this is a pipe dream, I fear that abundant and reasonably stable employment is incompatible with the voluntary principle.

39. O. M. W. Sprague (7, 5): At the 1943 annual convention of the National Association of Manufacturers a platform was adopted which included a pledge that American industry would "do everything within its power to produce and distribute better goods in greater volume at lower prices to more

people to make opportunity and jobs available to everyone." This is indeed a counsel of perfection, one which if it should become the major economic objective of government as well as of industry would, I feel confident, reduce the problem of unemployment to quite manageable proportions.

The implementation of this policy of more goods and services at lower prices throughout the entire field of production and marketing cannot be expected as an outcome of unfettered free enterprise alone, nor will it be attained through government intervention largely influenced by lobbying pressure groups, obstructing the steady enforcement of competition.

On the production level the accomplishments of free enterprise are impressive, though even here the astonishing Russian performance suggests that claims for the overwhelming superiority of our own system may perhaps be somewhat exaggerated. Further technological advance is certain and presumably at an accelerated rate now that industrial research begins to take on almost the characteristics of mass production—a development which suggests that the time is ripe for a re-examination of our ancient patent system. Moreover, thanks to metallurgical and chemical research, we may reasonably anticipate not a little weakening of the monopolistic situation in the case of various important materials and finished products. Even so, supervision by the trust division of the Department of Justice will no doubt continue to be desirable.

Industrial progress and efficiency make possible the production of more and better goods and services, but maximum production and full employment also require the presence or expectation of a profitable demand. To develop and maintain an adequate demand on a self-supporting basis under free enterprise conditions, there is one and only one policy that can be effective. To produce more goods is a comparatively simple matter; to distribute more goods is quite another story. That involves, as the N.A.M. platform does not fail to assert, the distribution of goods at lower prices. Rapid technological advance unaccompanied by declining prices of the products the cost of which has been reduced is a positive cause of unemployment and inadequate use of resources.

Competition must continue our main agency for the establishment of prices in close relation to costs, but in the case of many consumer goods it would seem that competition is tending to increase costs along with the creation of illusory values. Consider, for example, the prewar multiplicity of styles in women's shoes, or the costly system of returns without charge at the stores. Or again the vociferous advertising of rival products that are similar in all essentials. Here is a wide field in which government might well not only permit but encourage agreements among competitors that would reduce costs and so make possible price reductions.

The narrow limitation of space to which participants in this symposium are subject allows mention of but one more field of co-operation between government and industry designed to reduce costs and increase employment—the construction industry, by common consent a conspicuous laggard in the development of effective organization. As the federal government is by far the most considerable patron of the industry in normal times and will surely

embark upon an enlarged building program in years of declining employment, it is in a position to take the initiative in organizing the industry along a broad front.

42. FREDERICK C. MILLS (5, 4, 1): In the initial phases of the period of transition and reconstruction the actions of government will dominate economic processes. The impact on the domestic economy of demobilization, termination of contracts, disposal of stocks of goods, and equipment, foreign relief and rehabilitation, and federal fiscal policies will be direct and compelling. The vast problems of international reorganization will call for governmental action, for nations will be the bargaining units in the decisions that determine the design of world economy.

The following considerations bear upon the division of functions between business and government in the years that will follow:

1. The trends of opinion that have led to the assumption by the state of police powers in respect of interstate commerce, competitive business practices, investment processes, the operations of the great exchanges, and working conditions in industry will not be reversed. The extension of such controls to cover organizations of labor is to be expected.

2. Public opinion will require that the state provide for citizens at large insurance protection against the hazards of industrial accident, unemployment, sickness, and old age.

3. In the past our economic activities have been guided preponderantly by the forces that prevail in a self-directing economy. Even today we depend on the processes of a free economy for the discharge of the major functions of production and distribution.

4. We have at present neither the detailed knowledge of economic processes nor the administrative powers necessary to a comprehensive and pervasive system of state control. We cannot say with conviction and warrant what are the strategic factors in secular growth or cyclical change. In the present state of our knowledge and administrative power we are not justified in attempting to bring the determinants of economic equilibrium under social control.

5. The public at large will not wait upon slow amelioration through automatic readjustment in the face of persistent mass unemployment and subnormal production. The state will not in the future sit out a major depression. Intervention in economic processes under these conditions is now a recognized responsibility of government.

In the postreconstruction period responsibility will rest on government for setting the framework within which individuals and corporations operate in producing and distributing goods, and for defining the limits within which freedom of contract and action may be exercised. The framework will be more sharply defined and more restricted than in the twenties; it will be a tighter framework in the international than in the domestic sphere. As in the past, the role of government will be essentially a passive one. The state will have, however, a major contingent responsibility for active participation in economic proccesses in case of economic demoralization or protracted impairment of living standards.

Within the framework and the limits of action defined by government,

private enterprise will have responsibility as the prime mover in economic activity—the original and most effective force. It will be the function of individuals and private corporations to create capital. It will be the function of enterprise to create new products, to devise new technologies, to perfect new ways of combining productive factors; that is, it will be the duty of private business to provide employment and to produce goods, subject to the ultimate intervention of the state if this central responsibility is not effectively discharged.

In any division of functions calling for correlated activities there are certain joint responsibilities. What we shall desperately need during the reconstruction period, and later, is an instrumentality for joint study and action by government and private enterprise. Integrated modern economies whose workings are necessarily affected by restrictions and controls require continuing scrutiny in certain aspects of their operations. The creation, use, and cost of credit, the creation, allocation, and cost of capital, the varied (and perhaps unsuspected) repercussions of certain control and fiscal activities of the state, the domestic consequences of international currency conditions and trade movements—these and other factors that bear upon the level of production attained and of national income achieved are necessary subjects of continuing research by agencies constantly concerned with the over-all effectiveness of the economy. Government and private enterprise alike have definite limitations of both knowledge and power in this sphere, but the task is one that cannot be allowed to go by default. It is a responsibility that should be shared. Perhaps the way of progress lies in the harmonious co-operation of agencies having some of the functions of the Board of Governors of the Federal Reserve System, the National Resources Planning Board, and the Committee for Economic Development.

In these remarks I have been concerned rather more with what I think the relative spheres of private business and government will be than with what they should be. It is proper to say that the division I have suggested as likely, provided private enterprise can achieve a fairly high and sustained level of employment and output, seems also to me to be a desirable one. We are moving and shall probably continue to move in the direction of greater social control. There is danger that we may overrun ourselves on that path. This danger has been accentuated by what I take to have been a faulty diagnosis of the economic ills of the thirties—a diagnosis that mistook cyclical difficulties for secular stagnation. It has been aggravated by unwarranted confidence in our present knowledge of the factors that determine economic development and in our ability to control economic processes at large. At the present stage of our economic development, in the present state of economic knowledge, and under present conditions of administrative power over economic processes, it is the part of wisdom, I believe, to make the fullest possible use of such self-generating and self-directing qualities as our economy still possesses. It is not inconsistent with this view, I suggest, to urge that government and business alike do all that can be done to improve our knowledge of strategic factors in economic change. If fuller control should later

become necessary, we should have better instruments than those we now possess.

43. SUMNER H. SLICHTER (17, 5, 1): My remarks this evening will deal with only a small facet of the broad question which the Program Committee has posed. The basic responsibility for the level and stability in employment must be regarded as the government's. Why? For the simple reason that the government is in a position to take account of the effect of its actions and policies upon the general situation. If the volume of investment opportunities is insufficient, the government can do something about it. Under a progressive income tax, for example, the marginal efficiency of capital differs for different individuals depending upon the level of income of each. Our government has seen fit to take half or more of the marginal return of persons who do a large fraction of the savings in the community and who are best able to make risky investments. If too few people try to make a living or part of a living by venturing, by putting men and loan capital to work, the government can take steps to make business ownership more attractive. Consider, for example, the effect upon the attractiveness of ownership of more liberal offsets of losses against general income. If individuals and business enterprises show an excessive disposition to save, the government is in a position to discourage saving. If consumers and business enterprises accentuate fluctuations in business by going into and out of debt at the wrong time, if business enterprises accentuate fluctuations by accumulating and liquidating inventories, or by concentrating replacements of equipment at busy times, the government can provide incentives for a different timing. For example, a tax abatement might be permitted corporations which spend all their depreciation allowance for goods and equipment over a five-year period and in no single year of the five spend less than 80 per cent of their depreciation allowance for new plant and equipment. Indeed the government can do much more about the investment function, the schedule of liquidity preference, the propensity to save, and the timing of decisions than is generally realized—for these possibilities have engaged the attention of economists only for a few years and little has been done to explore them.

Thus the basic and most distinctive responsibility of the government in the economy is for *incentives*—to see that business enterprises, trade unions, trade associations, and individuals behave in the way that the prevailing scale of values requires. To the extent that the community places high and stable employment above other values, the government has the responsibility of seeing that enterprises, individuals, and organizations of all sorts have an incentive to behave so that employment is high and stable. A man might raise the level of employment in the community, for example, by becoming an adventurer and starting a business of his own rather than making a living by being on some one else's pay roll. But one can scarcely assert that it is his *duty* to start a business if he prefers to be a job holder rather than a job giver.

In contrast, consider the position of the business enterprise, the trade union, the individual. The enterprise, the union, the individual are too small

to consider the effect of their decisions and policies upon the general situation. They cannot afford to pursue certain policies simply because those policies are favorable to employment. They must select their policies on the basis of operating results. The business concern, the union, and the individual must be expected to pursue their self-interest (and indeed to have the "right") to pursue their self-interest regardless of the effect upon employment so long as they conform with the law and with the ethical codes of the community.

Everyone knows that the area of conduct controlled by ethical rules is broad—perhaps broader than that controlled by law. If the government has the basic responsibility of providing incentives for desirable economic action, what role is assigned to the ethical system? If people's conduct is not to our liking, if too many of them, for example, seek to make a living by job holding and not enough of them by job giving, should we change their behavior by changing the ethical system of the community or by changing the laws?

The capacity of a community to control conduct by developing new ethical rules may be regarded as one measure of the level of its civilization. Certainly a community which lacks the capacity to provide itself with many informal rules and to adapt them to changing conditions, invites a growth of minute and probably drastic legal regulations. Suppose, however, that there is a conflict over the kind of economic conduct which is desired. You and I, let us say, attack the prevailing ethical standards and seek to win acceptance for changes in them. If we fail, our last appeal is to the government. In a democracy this is not a body very much separate and apart from the people. It is simply one of the agencies through which individuals work out compromises between their more or less differing scales of value. It is, however, the agency in the community best able to control the incentives which control economic activity. Consequently, if full and stable employment has not been achieved, may one not say that the people have failed to insist that the government provide the incentives which full and stable employment requires?

44. EDWIN G. NOURSE (11, 19, 15): I am an avowed minimalist in delimiting the sphere of government in economic life; an avowed maximalist as to the sphere of private business. I define the role of government as that of creating a favorable milieu for the general practice of private enterprise, not actual operation except in a few limited classes of goods and services or the control or detailed direction of specific businesses.

As to the list of government functions, I follow tradition in putting the establishing of a system of money and of credit institutions at its head. But this does not entail a belief that fiscal policy or monetary manipulation should be relied on as the major means of activating and stabilizing our economic life. While the government—to wit, the federal government—must itself assume something of an operational role in the money market if the restrictive tendencies of finance capitalism, as we have known it, are not to interfere with the vigorous exercise of private enterprise, this should not carry it out of the role of sound though constructive banking credit into submarginal areas of "soft credit," where business is confused with vote-catching charity.

Another function of fundamental importance which government alone can perform is that of requiring full disclosure as to the facts of business opera-

tions which are of public concern. A very large number of private business practices which are harmful to the economy can live only in darkness. They would not have to be regulated away if the light of "pitiless publicity" were turned upon them; those who formerly had practiced them would thereafter abstain. If the present proprietors of business object that they "cannot do business in a goldfish bowl," this creates a presumption that they have real doubts as to the propriety of the ways in which they are doing business. It does not indicate that equally competent managers could not be found who would be willing to operate without the veil of secrecy. Our blue-sky laws and Security and Exchange Commission are the most striking phase of what we have already done in the direction of disclosure of facts.

I do not find myself able to accept either of the two rules most commonly advanced for dividing operational business between government and private agencies. The first of these rules would make government either the operator or the regulator of business "affected with a public interest." The second would leave "naturally competitive" business to private agencies and "naturally monopolistic" business to the government. All except the most trivial businesses are in a true sense affected with a public interest, and the great majority of business is, under modern conditions, so inevitably monopolistic or monopoloidal in the meanings significant for our discussion that the use of either of these rules would in practice throw the bulk of business quite promptly under government control. Because of the operative interdependence of all business, we would soon be constrained to throw the rest in, too—"letting the tail go with the hide."

I believe that closer approximation to a sound answer to the problem of government's role was attained in the agricultural industry prior to the advent of the AAA than we have thus far secured in any other field of business. This was exemplified by careful standardization of commodities and containers and of trade practices on a basis of full disclosure of facts rather than bureaucratic regimentation of acts. It included authorization and facilitation of co-operative organization but left the operations of the individual enterprise fully in the hands of the proprietor. All these private operators, however, had equal access to the best of scientific research and consultative guidance through experiment station and extension services. I would have been quite disposed to accept certain phases of agricultural adjustment as an evolutionary extension of this system if any way had been found for organizing somewhat larger units of overhead co-ordination without converting the system into a politically oriented pressure group. The recent proposal of forward pricing of major agricultural products under government guarantee seems to me a dangerous abrogation of the function of free markets.

The current disposition to throw major responsibility for the conduct of economic life into the lap of government suggests the search for a short cut instead of dedicating ourselves to the hard task of working out satisfactory results within the framework of a democratic system—"by blood and sweat and tears."

I should throw responsibility for the working of the economic system more definitely back upon the actual parties to that process, making them "stew

in their own juice" and suffer the consequences of their own economic stupidities. To the objection that we do not have time for such a process, I would reply that if their power of making their own experimental adjustments is not cramped by government interference and if they know they cannot run to a benevolent government to assuage the woes they bring upon themselves, workable solutions might come more rapidly than we can now believe. The intervention of the paternalistic state is not unlike that of the impatient parent who, instead of rigorously insisting that a child learn to perform well his own duties in the household, says, "Here, let me do it; I can't wait for you to learn."

A speaker on one of this morning's programs raised a question—and it seemed no more than a rhetorical question—"Is private enterprise in fact so much more to be desired than collectivism that we will tolerate a 10 per cent waste of resources to continue it?" I do not concede that we have to tolerate any such waste of resources as the price of having private enterprise. But as to the question whether we should pay the price necessary to bring private enterprise to its own attainable level of efficiency rather than fleeing to the ills we know not of under collectivism—as well as the alleged benefits—my answer is definitely yes. I believe that freedom of economic choice which rounded out the traditional "three freedoms" of the Founding Fathers promotes economic efficiency as well as adding important psychic satisfactions to the material goods and services which our money incomes can buy. The loss of this freedom must be given full weight as an offset against the assumed waste of 10 per cent of our resources if we do not accept statism.

*Concluding Remarks:* After the reading of the formal statements, the meeting was thrown open to discussion and to questions from the floor. The Chairman then summarized the discussion and presented a brief biographical sketch of the forty-five past presidents of the Association from Francis A. Walker, in 1886, to the retiring president, A. B. Wolfe. The material was taken from a tabulation of data compiled in connection with the preparation of the biographical sketches printed on the back of the series of presidents' photographs appearing in each number of the *American Economic Review.* The data included: the years each president served; the institution represented; the age at which presidents were selected; the date and place of birth; age, at present or at death; degrees, earned and honorary; institutions attended or at which they professed; titles of their Ph.D. dissertations and of their presidential addresses; their fields of interest and specialization; their publication, editorial, public service record and membership and offices held in learned societies; their marital status, religion, and politics.

# ECONOMIC POWER AS AN INSTRUMENT OF NATIONAL POLICY

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The concept of national economic power, in the sense of economic activity organized to buttress the military and naval strength of the nation-state, was familiar enough to writers on economic subjects, and particularly on international trade, in the preindustrial era. It is perhaps an oversimplification to group all these scattered writers into one school of thought and to find their common denominator in concern for the power of the state relative to its neighbors. Privilege was often uppermost in their minds; but they generally kept a weather eye open for the strategic aspects of economic policy, if only as a respectable argument to use in support of privilege. Even Adam Smith, who raked their arguments with devastating criticism, did not challenge the primacy of defense over opulence.[1]

It was only in the nineteenth century that political economy gave way to economics and English and American economists began to ignore, and even to be impatient with, considerations of national power. In the political and economic circumstances of the time it was quite natural for the classical economists to concentrate their studies upon the maximizing of wealth. England occupied a strategic situation of uncommon strength, her navy was supreme on the seas, and she had gained possession of the major strategic bases from which to dominate the trade routes of the world. Europe was divided and undeveloped. Americans had a continent of their own to conquer. Britain therefore was unchallenged in her development of international trade until well past the middle of the century and by that time her economic strength had grown enormously. The last quarter of the century, however, brought great strategic changes as the relative economic strength of Germany developed and conscript land armies were made mobile by railroads. The course of the first World War suggested to political geographers that sea power might be broken by using land-based forces to attack it from the flank or the rear at vulnerable narrow passages. Air power has now gone far to complete this revolution in strategy.

The bearing of power considerations upon economic policy, therefore, can no longer be ignored. Indeed there is at present a rather marked tendency for economists and political scientists to swing to the other extreme and maintain that power rather than wealth should be regarded

[1] Cf. Edward M. Earle, "Adam Smith, Alexander Hamilton, Friedrich List: The Economic Foundations of Military Power" in Earle (editor) *Makers of Modern Strategy* (Princeton, 1943).

as the fundamental concept of social science as energy is the fundamental concept of physical science. Bertrand Russell has argued this thesis and derived it from man's insatiable desire to share with God "the kingdom and the power and the glory."[2]

Power, however, is a vague word. Literally it means ability, the capacity to do something. The *Encyclopaedia Britannica* deals only with mechanical power which "as used by the engineer, indicates energy under human control and available for doing mechanical work." After considering various forms of mechanical power, the *Encyclopaedia* reaches the significant conclusion that "the history of the development of power shows a constant striving for greater economy, greater compactness of the units and greater capacity of each unit."

There seems no valid reason to regard power as necessarily malevolent rather than beneficent. Not the fact of power, but the use made of it, is significant for good or evil. In a context of human relations, however, ability inevitably suggests influence and influence suggests domination. It is not surprising to find, therefore, that the sinister sense in which the word power is so commonly used is almost as old as the word itself. The word power is seldom defined, but is left to suggest by inference sinister forces antagonistic to the common good. This is apt to create a vague sense of disquiet in the mind of the reader. It is reminiscent of St. Paul's stirring call to "put on the whole armor of God that ye may be able to withstand the wiles of the devil: For we fight not against flesh and blood but against principalities and *powers,* against the rulers of the darkness of this world, against spiritual wickedness in high places."

In fact the "powers" St. Paul was referring to were supernatural forces—angels, fourth class in the hierarchy.[3]

In examining the roots of economic power it is perhaps safer to rely upon analysis of human motives. One of the wise approaches to such an examination was that of Taussig in his little book, *Investors and Money-Makers.* After examining the instinct of contrivance, he devotes a good deal of his time to what is, I suspect, meant by most writers on power—what Taussig calls "the instinct of domination." From his extended analysis he draws a conclusion directly relevant to the theme of this paper:

> The instinct of domination is not necessarily ferocious or predatory; it may be satisfied by the achievements of peace as well as by those of war. Not a little has been gained through the mere circumstance that it is so largely shifted from the political and military sphere to the industrial. Better that we should have Napoleons of industry than the blood-guilty Napoleon of history.

[2] Bertrand Russell, *Power: A New Social Analysis* (New York, 1938).

[3] For the prevalence of demonology in the *New Testament* see C. E. A. Winslow, *The Conquest of Epidemic Disease* (Princeton, 1943).

This is the view still held by the captains of industry themselves. They draw a sharp distinction between political and economic power, maintaining that economic power can never be centralized except as an adjunct of political power. Conscious of their own industrial conflicts, they scoff at the notion of agreement among monopolists to control the machinery of the state. But they are fearful of state-imposed monopoly. At least they are fearful of state regimentation as long as they are conscious of their own industrial strength. It is only when threatened by economic disaster that they seek state support and accept its concomitant of state control.

Tempting as the subject is, this paper is not concerned with the use of economic power to influence or control national policy on domestic issues. Nor is it concerned with the relations between governments and those exercising economic power, in the formulation of national policies on international issues. I am aware that some of my colleagues may feel that these are the vital issues that ought to be discussed. I agree that it is important to locate the seat of actual power in regard to both domestic and international policies. Who, in the last resort, determines policy is an important question to answer. But it is not the question to which this paper is addressed.

The subject I propose to examine briefly and summarily might be defined as the relative power position of the United States in the modern world insofar as that position depends upon the use made of its economic capacity. If space and time were available it would be relevant to discuss the issues I have just referred to—who organizes that economic capacity and for what purposes. But in this short treatment I can take time only for the broader questions of whether the economic capacity of the United States does in fact constitute a source of national power and if so how it can best be used in the circumstances of the modern world.

For the first time in many decades—indeed for the first time since the very earliest years of the infant republic[4]—attention is now being paid by soldiers and political scientists, but little as yet by economists, to the power position of the United States in the modern world. This attention is part of the re-examination of national policy made necessary by the fact that this war has shown the folly of complacent and self-centered isolationist theories and attitudes. The United States, clearly against the desires and to the dismay of many of us, has to face the realities of power politics. In order to do so intelligently it must examine carefully not only its own power position but those of its potential friends and enemies.

To deplore this development would be childish. To construe frank

[4] Cf. Earle, *op. cit.*

and objective studies of economic and military potential in this and other countries as a preparation for Machiavellian pursuit of immoral national purposes would be to mistake their whole purpose. The use of power by a national community, as by an individual, need not be egotistical or antisocial. Power politics has a sinister ring in many ears, but there is no longer any possibility of the United States taking a Pharisaical attitude in these matters. Americans must now ponder seriously the wisdom of Pascal: "Justice without force is impotent. Force without justice is tyrannical. We must combine justice with force." It is necessary, therefore, to explore carefully the implications of the official policy stated by the Secretary of State that the United States will join in measures to keep the peace "by force if necessary."

National power is clearly a relative rather than an absolute concept. The capacity of a nation-state to make its influence felt in its relations with other nation-states depends upon the capacity of these other states as well as its own. Since, in the last resort, influence depends upon the will to use force of one kind or another—unilaterally, or in combination with allies, or in support of some form of international organization—economic capacity clearly represents a potential reservoir rather than a readily available instrument of power. In modern conflict, as throughout history, battles, even the preliminary battles of diplomacy, are won by being able to mobilize the most effective force soon enough at the actual point of conflict. History is full of examples of wealthy communities overrun and dominated for long periods by militarist-minded and organized peoples far inferior to their victims in numbers and economic capacity. Preparedness, at least sufficient to withstand the first shock of aggression, until time can be gained to mobilize economic capacity for military purposes, is, therefore, an essential element of our problem. Reliance merely upon potential economic strength can be, as it often has been, an invitation to disaster.

It is relatively easy to demonstrate that the economic capacity of the United States at the close of this war will be very strong, both absolutely and relatively to that of other nations. Temporarily at least, this commanding economic position will give its representatives great potential influence in determining peace terms and in organizing the postwar world. The extent of this influence may, however, be limited both by division and irresolution at home and by failure of public opinion to allow or ratify concessions to the policies of other nations and particularly to those of the U.S.S.R. and Great Britain. Not even the strongest power can have all its own way and it is likely to have less than it could have if its negotiators cannot count upon realistic and resolute support at home.

In the somewhat longer run it is as well to remember that estimates and recent statistics of economic production and resources cannot safely be extrapolated, except upon the assumption that production and trade will continue to be organized much as at present. The United States is a strong economic power in a capitalist world of equal trading opportunity. It is not so clear that it would be equally strong, relative to other nations and groups of nations, in a world organized in great autarchic empires or blocs. It is conceivable, for example, that a future rapprochement between the U.S.S.R. and Germany, resulting from failure to reach full understanding with the U.S.S.R. in the peace settlement, might force such a reorganization of production and trade as to weaken the economic capacity of the United States, both relatively to the new combination and even absolutely. There are weak spots in the American armor and not least the fact that the American people do not take kindly to hardship or discipline in time of peace. Moreover, as industrial consumption progressively encroaches upon the reserves of basic raw materials, the need for access to foreign materials increases. The situation in respect of petroleum is already sufficiently serious to cause some alarm for the future. This situation will clearly be aggravated if rubber must be made from petroleum.

In trying to estimate the probable economic strength of the United States relative to other powers in the measurable future, economists have a duty to insist upon economic experience which may be unfamiliar to students of strategy. A single illustration may suffice to emphasize this point. The shortage of rubber experienced in this war, followed by the development of a large production of synthetic rubber, inevitably suggests the possibility that it might be advisable for the future to rely, even at some economic cost, upon domestic sources of supply for such an essential material. The same point will come up in many other connections, especially perhaps in regard to shipping. There will be a natural commercial interest in advocating protection for these vital industries in which so much investment has been made and this commercial interest will be supported by arguments derived from strategic considerations.

Most economists now would, I believe, agree with Adam Smith's view that if a choice must be made, defense must take precedence over opulence. Most also would probably agree that military preparedness supported by economic preparedness should not again be neglected. The question is whether such preparedness involves the necessity of protecting such industries as synthetic rubber. It would probably be agreed that in future a large stock pile should be kept available. Also that some proportion of synthetic production should be maintained

either by government operated plants or subsidized private industry. A system of shadow factories would probably be regarded as a justifiable expense in the nature of war insurance.

What is much more doubtful is whether the indirect cost of restricting imports of raw rubber by means of a protective tariff high enough to maintain full production from the synthetic factories would not be so great as to outweigh the gain from an assured supply of an important raw material. The welfare of the native peoples of Malaya and the Netherlands Indies cannot be ignored. If they are deprived of an important part of their livelihood—tin must be considered along with rubber in this region—an economic situation may be created which would present Japan and Germany with opportunities to develop bilateral trade that would give them cheap materials and at the same time enable them to build up economic and political dominance in these regions.

Moreover the dollar exchange—amounting for tin and rubber to perhaps $500,000 a year—is a most important link in the multilateral balancing of payments. Not only southeast Asia but the British Commonwealth and the Netherlands are involved in this triangular trading. The loss of such a large credit item at a time when these areas are already short of dollars would probably force them into regional or bilateral rather than multilateral forms of trading. The United States might, therefore, find itself faced not only with a loss of export outlets and restricted access to other important raw materials, which might perhaps include petroleum, but it might also find that its efforts to re-establish a multilateral trading system in pursuance of Article VII of the Mutual Aid Agreements were checkmated. It is a major economic, political and strategic interest of the United States that multilateral trade should be restored. In a world of expanding multilateral trade, American manufacturing industries may count upon increasing strength. In a world organized as a series of preferential or exclusive trading blocs, the United States would probably face severe industrial dislocation and unemployment within its own borders, and a consequent weakening of its economic strength. It would, moreover, be forced to adopt both domestic and external measures of economic regulation to mobilize its economic activity in competition with the practices adopted by rival groups.

The methods by which economic activity can be mobilized in the service of the state are now well known. Albert Hirschmann, in a book entitled, *National Power and the Structure of Foreign Trade,* which will soon be published by the University of California Press, has analyzed the complementary methods by which a great state may use its economic power to influence and dominate its weaker neighbors.

Essentially these methods resemble those which are familiar to economists in the practices by which great industrial monopolies cajoled, bought, or crushed independent competitors. Trade is concentrated upon smaller units so that it becomes essential to each of them while negligible to the dominant country. Once this dominating relationship has been created not only the terms of trade but the conditions of production in the dependent areas can be manipulated to strengthen the war potential of the dominant state. There is a whole armory of technical devices available, but it is only when control of the domestic economy is absolute that economic power can be used effectively in this way as an instrument of national policy. With such absolute control even an impoverished nation-state can quickly transform its economic weakness into armed strength, provided only that its potential victims remain divided and irresolute.

Economists could, and many did, calculate the odds against Germany being able to wage a successful world war. Their calculations are now being proved correct; but they were very nearly wrong. Adding one small state after another to its empire, making temporary alliances with or neutralizing rival dictators, the Nazi leaders almost succeeded in proving once again that wars are won not by unmobilized economic potential but by getting there first with the most men, and, we must now add, with the most equipment. Only the fortitude of the British in adversity and the extraordinary miscalculation of the situation made by Hitler in attacking the U.S.S.R., gave time to mobilize the superior economic resources of the free world. It may be argued perhaps that these are the imponderables upon which the issues of war turn; but we have no right to count upon such imponderables turning in our favor.

It may be noted in passing that a state which is economically and strategically in a weak situation at any given moment is not bound to disclose its hand by declaring the ultimate objectives of its policies. The re-establishment of its power position can proceed by stages. For example Japan, stripped of its conquests, including such early conquests as Formosa, would lack the outposts and island bases necessary for defense. Presumably, also, its military air and naval establishments would be eliminated by enforced disarmament. Its industries would become dependent upon imported raw materials and might well suffer serious deterioration. Temporarily Japan would be greatly weakened both in economic capacity and in military power.

Such weakening, however, is seldom of a lasting character. The rapid recovery of Germany after a crushing defeat, revolution, and violent monetary disturbances ought to give us pause before we rely upon the undoubtedly strong position that will be ours at the end of the war. A

resurgent Germany proceeded cautiously, step by step. Its first actions were experimental and not such as to evoke strong reaction from the by now divided victors. In the main they were in the sphere of economic warfare. Their cumulative effect, however, was to facilitate bolder steps in regions difficult for Britain and France to reach quickly in effective strength. After Austria and Czechoslovakia came Poland, but by this time the challenge had to be met by a declaration of war for which Britain and France were ill-prepared.

What is to prevent Japan, after a period of quiescence and suffering, building up trade relations again with areas that are important to its economy as sources of raw materials and to its strategy as potential bases of future operation? Indeed if the United States continues its high tariff policy while the British and Dutch continue tight controls of Japanese imports into their colonial areas, Japan may be forced into directing its exports into concentrated bilateral trading channels. India, Indo-China, Siam, and Burma, as well as China, are obvious cases where reciprocal trade can be fostered and it is at least possible that India and Burma may be independent. It does not require much imagination to conceive circumstances in which Japan might build up a strong trading position in southeast and southern Asia. The time might come when it would be relatively safe to reoccupy Formosa and Korea either because the United States and its allies were preoccupied, or divided in their policies, or because they could not get sufficient force to these areas in time to prevent effective occupation and were reluctant to risk a major war in ejecting the Japanese.

At this point one should add that reliance upon economic sanctions is insufficient as a precaution against aggression. The imposition of such sanctions if severe enough to interfere seriously with the aggressive designs of a great power will always provoke war. If it is not severe, it actually stimulates the adoption of national economic policies of self-sufficiency and bilateral trading that are desired for militarist reasons.

It is sufficient to cite these possibilities to make the point that relative power based upon economic potential at the present time is not a safe guarantee against future aggression. Economic potential must be translated into military force at a given point at a given time. This requires not only careful intelligence work and efficient mobilization, but also a sustained will to take resolute action without delay in situations where there may well be doubt as to the justice of such action. Experience does not lead to any great confidence that democracies will be vigilant or united in such matters.

These facts bear a lesson for the future. There is every reason for us here in the United States, robbed as we have been of our comfortable and complacent isolation, to calculate the economic and military strength

of our potential friends and enemies. Whether we like it or not we have been pitched headfirst into power politics. Henceforth our national policies cannot with impunity ignore power considerations, and among them the economic potential upon which modern armies, navies, and airfleets must depend. Those are right who point out that in the foreseeable future the economic power controlled by the United States and our major allies, the U.S.S.R., China and the British Commonwealth and Empire, is likely to be overwhelming against any conceivable combination. But they are right only if two assumptions are fulfilled.

The first assumption is that these aggregations of power work together and not in conflict. The second, equally important, is that in their concern for economic welfare they do not relax their precautions against renewed aggression. Close and continuing collaboration between these mighty powers could assure the world of security at a minimum economic cost, thus opening up great possibilities of enhanced economic welfare for the common people everywhere.

The question remains as to the best method of ensuring such close and continuing co-operation. Here, perhaps, one may recapitulate the argument up to this point. Power, involving the possible use of force, is not necessarily evil but may be used to achieve moral purposes. Reliance upon mobilized economic power at any given moment is dangerous. Economic strength is an important component of national power, but it is not effective unless it continues to be mobilized and to be focused against possible danger points. Such mobilization demands not only an alert awareness of potential danger, which may be present in economic or other apparently peaceful developments but may arise in remote and inaccessible areas. It also calls for a sustained will to take resolute action which may sometimes seem, or be represented, to be highhanded. Such action may be unilateral on the part of a dominant power, or it may be concerted or divided among a group of powers in agreement, or it may be used collectively as police power in a world system.

It does not seem likely that the United States either can or will discipline its economy in the way that would be necessary if its economic strength is to be used as an instrument of political domination. This would not only represent a heavy, and probably intolerable, drain on its resources, but would call for such a degree of domestic and external regulation as to cause a revolution in its political and economic structure. The practices made familiar to us by Germany in extension of its economic power over the continent of Europe are alien to American traditions.

There remain only the alternatives of a nuclear alliance among the great powers or a collective system in which force is placed at the dis-

posal of a world organization to be used as police power. I do not believe that these are real alternatives in the sense of being exclusive one of the other. There is no escape from the fact that responsibility goes with power. The great powers have and must have the greatest responsibility for the maintenance of peace. The best and most practicable way for them to discharge that responsibility is in and through a collective organization in which the great powers take a leading but not necessarily an exclusive part. If such an organization is created it will depend for its success upon the continuing support afforded to it by the great powers. The smaller powers can be counted upon for moral, and at times for useful material, support; but they are not able by themselves to take decisive action.

From an economic point of view the contributions necessary, in the adaptation of national policies necessary to secure agreement as well as in more direct ways, should be regarded as an insurance premium against the disaster of war. As such they are a small price to pay for the security that will enable the nations once again to devote their economic resources and energies to the enhancement of economic welfare. Of all peoples in the world today the United States has most to gain from such a development and most to lose from failure to achieve it. In a peaceful trading world the United States is rich and powerful. In a world of warring alliances its situation might well become precarious and relatively weak.

# INTERNATIONAL TRADE

## INTERNATIONAL RELATIONS BETWEEN STATE-CONTROLLED NATIONAL ECONOMIES

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This paper deals with some aspects, primarily some "politico-economic" aspects, of the probable pattern of international relations in a world of sovereign nation-states in which all or most of the national economies are "state controlled." By a state-controlled economy, I mean one in which the major decisions of what is to be produced, exported, imported, lent abroad, borrowed abroad, etc., are exercised by the state (or agencies thereof), as distinguished from a "free enterprise" economy, where the decisions are predominantly in private hands and are made on the basis primarily of calculations of private profit. State control may take the form of merely bureaucratic control, or of direct operation of business activities, or of intermediate types of governmental intervention. The only type of governmental intervention which is not intended to be included in the concept of state control, not a very prevalent type, is governmental interference with private enterprise with the purpose and effect of making it conform more closely with the principles of free competition.

I do not here use the now popular term of planned economy because there is no common understanding among users of the term as to how much—or for that matter what kind—of governmental control of the economic process it implies. It is essential for my argument that by a state-controlled economy be understood one in which the extent of state control goes much farther than it did, say, in the United States, England, France, Sweden, or Canada, in the twenties or even in the thirties, although what I have to say has implications for any substantial degree of substitution of decisions of state for decisions of (small or moderate-scale) private enterprisers. But there is one point which recurs in the recent literature on national planning on which something needs to be said here. To assuage the fears of those who find a menace to peace or prosperity or freedom in the extension of state-power over economic activity, exponents of national planning sometimes say that "the real issue" is not how much economic interference by governments but what kind of interference and for what purpose? I must insist that both questions raise real issues, that the kind and the purpose of the interference depend in large part on the degree of interference and that this paper is largely concerned with the kind of interference which tends to result in the international sphere when the degree of interference is substantial.

I have already dealt elsewhere and at some length with the technical economic problems arising for free-enterprise economies in their trade relations with national economies whose foreign trade is state controlled,[1] and I will not deal with these problems in this paper.

Whatever differences in the pattern of international relations should be expected to exist as between, on the one hand, a world of free-enterprise economies and, on the other hand, a world of state-controlled economies would be mostly the consequence of the differences in the types of behavior in the field of international relations, as between private enterprise, on the one hand, and governments conducting or directing economic activity, on the other hand. Both theoretical analysis of the nature and mode of operation of private enterprise as compared to government activity and historical evidence disclose certain differences in the two types of behavior.

1. Private enterprise, as such, is normally nonpatriotic, while government is automatically patriotic. The only important exceptions to this rule are to be found in the behavior of certain hermaphroditic corporations, which in form are more or less routine instances of profit-seeking private business, but in mode of operation are only with some difficulty distinguishable from governmental agencies. Such were some of the chartered trading companies of the Mercantilist period. In more recent times, such is the Bank of England, and such was the British East Africa Company, which, set up as a corporation to earn dividends for its shareholders, sank much of its proprietors' capital in the extension of territory for the British flag to fly over. Giant private corporations in general tend to acquire institutional objectives other than their proper ones of maximizing their shareholders' profits. These objectives occasionally have or seem to have a patriotic character, but it may generally be safely assumed that they have not been adopted by the corporations on their own initiative or of their own free will but have been accepted under government coercion, real or imagined or anticipated. Perhaps I should explain that for present purposes I will take "patriotic" activity to mean the deliberate utilization of privately-owned resources by the owners, at financial cost to themselves, to serve national ends of power, prestige, or prosperity.

It follows that the pattern of international economic relations will be much less influenced by the operation of national power and national

[1] "Trade Relations Between Free-Market and Controlled Economies," *League of Nations Publications, II. Economic and Financial,* 1943, II, A. 4. Acknowledgment of my authorship and an appropriate disclaimer on behalf of the League of Nations of responsibility for the specific contents of the memorandum can be found in Dr. A. Loveday's Preface. In the case of this paper, also, the views expressed are to be taken as the purely personal views of the writer, and as not in any way involving in responsibility for them any institution or agency with which he may now be or may at any time in the past have been connected.

prestige considerations in a world of free-enterprise economies than in a world of state-operated national economies. This "denationalized" character of private business is of course an ancient phenomenon. It was probably carried furthest during the golden age of freedom of "free enterprise" from governmental control in the middle of the nineteenth century. It was carried far, however, even during the Mercantilist period, which, in the matters dealt with in this paper, is closest to our present age and trends of all past periods. Under Mercantilism, there were important branches of industry and commerce where the state held a tight rein, or even established state monopolies. But there was also a residual area, even in the international field, in which the legally recognized and protected freedom from state interference went further than anything we are now familiar with. Even as far back as Magna Carta the effects of foreign merchants were protected against seizure or confiscation in case of war against their state. As I read the evolution of international law under modern capitalism, as revealed from before 1600 to 1914 in the detailed provisions of international treaties, one of its outstanding characteristics was its attempt to build a legal protection for property and for private enterprise from the power activities of foreign states both in times of peace and in times of war. This protection was even extended to the property interests of nationals of one's own state which served enemy states and to the property interests of nationals of enemy states, sometimes with what, from a patriotic point of view, would seem to be fantastic results, as, for instance, when in the eighteenth century British insurance companies were free to insure the French owners of French merchant vessels against the risk of loss from capture by British naval vessels, or when during the Crimean War the British foreign minister lamented the absence of legal barriers against the London money market financing Russia's military activities against Britain.

2. If international business is conducted by private enterprise it will for the most part be conducted on a substantially competitive basis. The difficulty of organizing monopoly is ordinarily too great to make its achievement on a durable basis and with a high degree of monopoly power possible except by virtue of governmental aid in the form of special franchises, concessions, legal sanctions against breach of monopoly agreements, or biases, deliberate or fortuitous, in the tax system against small-scale enterprise. Even when business achieves a high degree of monopoly power in the domestic field, competition from foreign sources and protective measures by foreign governments will often prevent it from attaining an appreciable degree of monopoly power, whether as buyer or as seller, in the foreign trade field. A government engaged in economic activity, on the other hand, even if it is only moderately centralized and administers its affairs with only moderate efficiency, will

achieve monopoly power almost effortlessly and automatically within at least the range of operations subject to its jurisdiction. Even if government is itself loose and decentralized, or disinclined to engage directly in commercial enterprise, it can delegate to specially chartered companies, as in the Mercantilist period, the task of exploiting its potential monopoly power. Whatever potential monopoly power, whether as buyer or seller, therefore, is inherent in the economic position of a national area, is much more likely to be largely exploited if government assumes the task, than if it is left to the unassisted initiative of private enterprise.

3. The process of competition—provided, as is generally the case, the competition is not completely "free" in the technical sense—will in the normal course of events give rise to a constant stream of allegations of chicanery, misrepresentation, gouging, unfair discrimination, and others of the less attractive manifestations of the Mercantile art. If the alleged perpetrators of such practices in the international field, as also those who feel themselves injured thereby, are private individuals or firms, the resultant ill-feeling may put a strain on the maintenance of friendly relations, and if the individuals or groups concerned are influential may find expression in diplomatic complaints by the government of the aggrieved individuals. Where either perpetrators or victims are governments, however, and even more so if both parties are governments, the sense of grievance will result much more directly in an issue between governments, and the fact that a government, or governments, is involved will give the incident a much greater potency in inflaming public opinion in the countries concerned. The process of substitution of government business for private business is in the international field, therefore, also a process of transformation of private quarrels into intergovernmental quarrels.

This transformation of private quarrels into governmental quarrels is dangerous for peace. This is not only because resort to force is an immediately available instrument of persuasion for governments, and not only because the boiling point of patriotic public opinion is lower where governments are immediately involved in controversies than where either they are not formally involved at all or are involved only because of their intercession on behalf of individual nationals. There have been developed, in the course of centuries, detailed and elaborate codes and routine judicial procedures whereby disputes on commercial matters between nationals of different states can obtain adjudication in the courts of one or the other of the states upon the initiative of the complainant and on precisely the same terms as if both parties to the dispute were nationals of that state. These codes and procedures are, of course, incomplete in their coverage, and full enjoyment of the national standard

of justice of the defendant's country may often leave the complainant with the feeling that all that he got thereby was the addition of insult and legal expenses to the original injury. The situation in the private field is nevertheless incomparably better in this respect than in the field of intergovernmental relations. Here there is no code—except for the code of war! Except for mutual agreements, of very limited scope and effectiveness, for resort to arbitration or impartial adjudication, the only available procedures are diplomatic process, which in such cases is liable to be little more than a mechanism whereby threats and mutual recriminations can be transmitted in the most polite language; resort to political or economic reprisals; and, in extreme cases, or in cases where the aggrieved country appears to itself to be clearly the stronger, resort to force. The modern tendency to substitute *jure gestionis* for *jure imperii* (or the commercial code for the power code) where governments engage in business is not a real exception to the proposition laid down here, partly because the *jure gestionis* is by the nature of things applicable only to a very limited range of government activities in the economic sphere, and partly because there is a *jure gestionis* to apply only where private enterprise is still predominant.

A close parallel can be drawn between the logical pattern of the political and military power relationships of states to each other, on the one hand, and, on the other hand, the economic power relationships of business firms to each other when they are operating in a framework of bilateral-monopoly-plus-duopoly. When governments are also conductors of economic enterprise in the international field, what results is a pattern of intergovernmental relationship in which economic, political, and military bilateral-monopoly-plus-duopoly are all wrapped up in one package of international dynamite. There is then in international economic relations the same impossibility as in the field of private duopoly or bilateral monopoly of attaining stable equilibrium except by the Draconian methods either of smashing all the large units into atoms or of merging all the large units into one. In the private economic field the instability of equilibrium is of itself of no large consequence except to the pure theorist whose conventional diagrams are thereby rendered meaningless. In the international field where the monopolists are governments, however, the impossibility of reaching stable economic equilibrium has grave significance, for it involves as a corollary the persistence of economic factors working powerfully against the attainment of stable political equilibrium. Transfer of international business from private to governmental hands thus involves not only the economic costs of substitution of monopolistic for competitive procedures, but also the grave political disadvantage of the absence of any code or of any agency to enforce a code if one existed. Moreover, even

if agencies could be established to enforce a code of rules, no one seems as yet to have discovered even the elements of a possible pattern for such code which would have some logic, be reasonably fair to most parties under most circumstances, be simple enough to be administrable, and be acceptable to countries which feel themselves to be possessed of relatively strong bargaining power.

To sum up the argument so far, I have tried to establish the propositions that the substitution of state control for private enterprise in the field of international economic relations would, with a certain degree of inevitability, have a series of undesirable consequences, to wit: the injection of a political element into all major international economic transactions; the conversion of international trade from a predominantly competitive to a predominantly monopolistic basis; a marked increase in the potentiality of business disputes to generate international friction; the transfer of trade transactions from a status under which settlement of disputes by routine judicial process is readily feasible and in fact is already well-established to a status where such procedure is not now routine, where a logical, administrable, and generally acceptable code does not seem to be available, where, therefore, *ad hoc* diplomacy is the best substitute available for the nonexistent law or mores, where diplomacy will by inherent necessity be such that the possibility of resort to force in case of an unsatisfactory outcome of the diplomatic negotiations will be a trump card in the hands of the powerful countries, and where weak countries will have to rely for their economic security primarily on their ability to acquire powerful friends, who will probably be acquirable, if at all, only at a heavy political or economic price.

I am aware, of course, that the foregoing, in its tacit assumption that all types of state-controlled economy would, in their international economic relations, follow the same evil pattern of behavior, will sound like irrelevant abstraction or even like willful paradox to many. Socialists in particular, who have been brought up in or converted to the belief that a world of socialist states would be a world in which international relations, in the political as well as in the economic field, would be relatively frictionless as compared to anything we have known in the past, and that peace, harmony of interests, and mutual collaboration would come almost automatically in a socialist world, will be moved to strong protest. I am not able myself, however, to find any logical basis for confidence that if only state-controlled economies were equalitarian and democratic—which, I take it, would make them "socialist"—that would of itself take the curse off state control. A fairly extensive search of socialist literature, moreover, has not disclosed to me much beyond mere dogmatic assertion on this point.

Since the issue is clearly an important one, this relative failure of socialists to explore it more thoroughly seems to call for explanation. As I see it, the explanation lies primarily in the circumstances in which the socialist movement had its origin and its early development. When socialism is but an aspiration, socialist movements are by psychological necessity utopian in character. The efficient missionary does not dwell on the possible existence of familiar plagues even in his promised land. The socialist doctrine, as we shall see, contended that in a capitalist world capitalism was the source of war, and much of the emotional appeal of socialism came from the success of its advocates in associating the idea of the overthrow of capitalism with the idea of the abolition of war. That the same method of argument used by the socialists to show that in a capitalist world capitalism was the cause of war might be used with comparable plausibility to show that in a socialist world socialism would be the cause of war, it would be demanding too much of a propagandist movement to see and to acknowledge. As Engels once pointed out to Marx—surely gratuitously—"true socialism is a movement which . . . theoretical impartiality, 'the absolute calm of thought,' would drain of its last drop of blood, its last trace of energy and elasticity."

It is—or was until the rise of Hitler—orthodox socialist doctrine that war arises out of the conflict of economic interests between the ruling classes of different countries. Under capitalism, in particular, the workers, as a class, have no fatherland, have nothing to gain from victorious war. Wars are fought by them, but never for them. The socialists, nationalist or imperialist, or merely objective, who questioned this doctrine, risked excommunication. As samples of conventional formulations of the doctrine, I cite, from the very many available, two statements, one by an English "liberal," J. A. Hobson, who in these matters was accepted as a guide by the avowed socialists, and the other from an authoritative Soviet source, so as to include both poles of socialist belief:

> The apparent oppositions of interest between nations, I repeat, are not oppositions between the interests of the people conceived as a whole; they are expositions of class interests within the nation. The interests of America and Great Britain and France and Germany are common. The interests between certain groups of manufacturers or traders or politicians or financiers may be antagonistic at certain times within these groups, and those antagonisms, usurping the names of national interest, impose themselves as directors of the course of history; that is the actual difficulty with which we are confronted. . . .[2]

> The capitalistic structure of the various States and their competition on the world market, the chase after profits and super-profits are creating among them irreconcilable contradictions which unavoidably will lead to international conflicts—so long as capitalism exists.[3]

This doctrine of the purely economic causation of war and of its

[2] J. A. Hobson, "The Ethics of Internationalism," *International Journal of Ethics,* XVII (1906-07), 28.

[3] Communist Academy, Moscow, *Encyclopedia of State and Law,* 1925/1926, p. 749. i, as cited in *International Conciliation,* No. 386, January, 1943, p. 24.

special affinity with capitalism and its associated class structure was not confined to socialists. After the last war, in fact, it was the prevailing doctrine taught in American colleges, especially in the history and political science departments. As I know to my cost, to question its validity before the properly indoctrinated undergraduate "Liberal Clubs" of the time was to disclose oneself as either incurably naïve or a hireling of the capitalists. It is my impression that economists for the most part escaped the contagion. But this may have been because they were void of any ideas or knowledge with respect to the history of international relations rather than because they were less susceptible than professional historians to uncritical acceptance of gross distortions of history. Even when expounded by historians, the doctrine was in no case that I am aware of the product of genuine and reasonably objective historical research. For the most part, no research of any kind or quality was involved, and the doctrine was a belated and corrupt example of that "conjectural or theoretical history," that *histoire raisonnée,* which is a legitimate substitute for the objective scrutiny of recorded facts only, if ever, when the relevant facts are not ascertainable even at the cost of great effort and toil.

I do not mean to assert that when historians and political scientists, "liberals" and socialists, expounded this doctrine they did so wholly in abstract terms. The doctrine was basically a priori, but it was often dressed up in alleged facts. There was accumulated in fact, at the cost of what must have been for some persons a considerable effort in getting things wrong, a set of conventionalized accounts of the origin and motivation of some notorious episodes in the history of modern imperialism, which provided a stock ready at hand of stage properties available for all who wished to present the melodrama of peace murdered for profit by the evil capitalist. I am particularly fond of a statement of the doctrine in historical terms by Harold Laski, because in a single paragraph he cites almost every one of the stock episodes in the repertoire:

> No one now denies that the British occupation of Egypt was undertaken in order to secure the investments of British bondholders; and that the South African War was simply a sordid struggle for the domination of its gold-mines. The French invasion of Mexico under Napoleon III was an effort to protect the interest of French investors in that ill-fated state. Nicaragua, Haiti, San Domingo, to take only the most notable cases, have all been reduced to the position of American provinces in the interest of American capitalists. The Russo-Japanese war was, in the last analysis, the outcome of an endeavour by a corrupt Government to defend the immense timber-concessions in Manchuria of a little band of dubious courtiers. The savage cruelties of the Congo; the struggle between British and American financiers for the control of Mexican oil; the fight between Germany and the Entente for the domination of pre-war Turkey; the reduction of Tunis to the position of a French dependency; the Japanese strangulation of Korean nationalism; all these are merely variations upon an identical theme. Men have sought a specially profitable source of investment. They have been able to utilize their Government to protect their interest; and, in the last analysis, the Government becomes so identified with the investor, that an attack on his profit is equated with a threat to the national honour. In those circumstances

the armed forces of the state are, in fact, the weapon he employs to guarantee his privilege.[4]

Of all this long series of positive assertions as to historical fact, there is not one which would withstand even the most cursory inspection. Historical episodes always seem to grow more complex as one learns more about them, and I am sure that no one simple pattern of interpretation will fit any two of these episodes. But of almost all of these episodes this at least is true, that if you exactly reverse the role of the capitalist vis-à-vis his government assigned to him by Laski, you will be much closer to the truth than he is. In almost all of these cases, the capitalist, instead of pushing his government into an imperialistic enterprise in pursuit of his own financial gain, was pushed, or dragged, or cajoled, or lured into it by his government, in order that, in its relations with the outside world and with its own people, this government might be able to point to an apparently real and legitimate economic stake in the territory involved which required military protection against unfair treatment or general misgovernment by the local authorities or against encroachment by other powers. In perhaps two or three of these cases, illegitimate profits of investors, even in terms of bourgeois morality, were notoriously involved. But seekers of illegitimate profits are likely to try to find a foothold in any large-scale operation, and will sometimes succeed. I know of only one case, of these cases, in which there is even plausible evidence that the act of imperialist aggression originated in a desire to promote the special financial interests of a small number of wealthy men. The one exceptional case was the case of the Congo. Here private profit was clearly the major, if not the sole, objective. But the profiteer and the imperialist statesman were here the identical person, King Leopold of Belgium, and the moral to be drawn from this case would seem to be the general moral I am trying to expound; namely, that it is dangerous to peace for governments as governments to engage in international business transactions.

If, following an example which is not respectable but has nevertheless been set by ultrarespectable historians and other scholars, I were to venture to make sweeping historical generalizations on the basis of scanty and conflicting evidence, I would be tempted to counter the scandal theory of the role of capitalists in aggressive imperialism with another theory in which the particular capitalists directly involved are pictured as for the most part the passive instruments of "peaceful penetration" and in which capitalists as a class operate much more as "appeasers" than as "war-mongers" even when the wars in question are righteous wars. That this theory would at least fit recent events fairly

[4] H. J. Laski, "The Economic Foundations of Peace," in Leonard Woolf, *The Intelligent Man's Way to Prevent War* (London, 1933), pp. 507-508.

well I am sure many here would agree. But even in the Mercantilist period, when the relations between military power policy and commercial policy were especially close, much of the "commercial" enterprise which was internationally aggressive in character was initiated by governments; those businessmen who were not given by government a special vested interest in these aggressive activities were on the whole hostile to them; it was not the middle or bourgeois classes who were the ruling classes; and the aristocrats, who were the rulers, were then, as in later times, impatient with the craven character of the moneyed classes and their preference for peace even as against successful wars.

While I suspect that Marx himself would not have hesitated to resort to the "scandal" theory of imperialism and war when convenient for propaganda purposes, I am sure that he would basically have despised it for its vulgar or unscientific character. In any case, the neo-Marxians have developed, alongside and conflicting with the scandal theory, another more sophisticated theory of imperialism and war which seems to my meager acquaintance with the Marxian system of thought to be much more in harmony with its inner logic. This other doctrine, instead of imputing imperialism to the profit-seeking machinations of a few unscrupulous capitalists, explains it as a natural and inevitable product of the *modus operandi* of the capitalist system as a whole. This theory has been expounded in terms of the famous three "surpluses"—of capital, of population, and of goods—held to arise inevitably out of the capitalist process, and to be susceptible of liquidation only by the acquisition by force or threat of force of industrially backward areas, which can supply hitherto unexploited fields for the employment of surplus capital, new markets for goods, and opportunities for settlement of the redundant workers of the older countries.

This theory, which, like the scandal theory, is accepted by many who are not, as far as they are aware, socialists, is certainly not without plausibility. There is no a priori reason why war should *not* arise from the search of more profitable fields than are available at home for the employment of capital, or from the desire for settlement colonies as a relief from population pressure at home, or from rivalry in obtaining privileged access to undeveloped export markets. Considerations of this character have, in fact, undoubtedly played a considerable role in the history of modern imperialism. These considerations, of themselves, fall far short, however, of accounting adequately for the prevalence of imperialism and war, either today or in any past period. Debtor countries alike with creditor countries, countries with declining population trends alike with countries conscious of acute population pressure, countries without commercial interests alike with actively trading countries, have engaged in imperialist ventures. Moreover, there is nothing in this theory,

except perhaps its assumption of an embarrassing abundance of capital in the aggressive countries, which justifies any special association of the three surpluses as causes of war with modern capitalism or any disassociation of them from the socialist state, or from any other form of nation-state.

In the socialist state, moreover, such considerations should be expected to be given more weight, and to exercise more direct and more forceful influence on policy, than in a capitalist society where free enterprise prevails. In the first place, the socialist state, with its unified and centralized administration, would be technically better equipped to harness the national resources to national policy than would a loosely-organized capitalist democracy. In the second place, the equalitarian element in the socialist doctrine, while it might create an ideological barrier against making demands on poorer countries, would provide a moral basis not available to capitalist countries for aggression against richer countries reluctant to share their riches with other countries. The equalitarian logic of socialism has no natural stopping place at national boundaries. Third, in the full-fledged socialist state an aggressive foreign policy directed toward economic objectives could not be checked at home by an opposition believing or asserting that the profits of the aggression would go exclusively to a small privileged class. One of the disadvantages of the socialist state in this connection, as compared to the capitalist state, would be the absence of an antipatriotic socialist opposition. Fourth, there would not be in the socialist state a powerful middle class with property interests to protect against risks of all kinds, including the risks of war.

The socialist, I suppose, would deny that the internationalist, pacifist, antipatriotic elements in the programs of socialist parties were wholly or even largely to be explained by the minority and opposition status of these parties—and, I would add, to the middle-class education of their leaders—and would contend that they would be as prominent in the policy of a socialist state as in the party program of a socialist opposition. Perhaps so, but I see no reason whatsoever for such optimism. Anti-imperialism, in fact, was by no means peculiar to the socialists, but was borrowed by them from the bourgeois idealism of the capitalist world. Except for the tendency to stress the evil role of the wicked capitalist, socialist internationalism was not distinguishable from the economic internationalism of those "lackeys of capitalism," the English classical school of economics, or of those "direct spokesmen of industrial capitalism," Cobden, Bright, and the rest of the Manchester School, including its Continental offshoots. Lenin himself cited as a "profoundly true and important utterance" Kautsky's statement that:

Modern Socialist consciousness can arise only on the basis of profound scientific knowledge. Indeed, modern economic science is as much a condition for Socialist production,

as, say, modern technology, and the proletariat can create neither the one nor the other . . . ; both arise out of the modern social process. The vehicles of science are not the proletariat but the *bourgeois intelligentsia.*[5]

This seems sound doctrine to me, and it is in keeping with it that I contend: that economic internationalism as doctrine is a product of bourgeois capitalism, and is consistent with it and with no other as yet known type of economic organization on a national basis; that the socialists, insofar as they adopted it, appropriated it from their fellow bourgeois intelligentsia; that the socialists found it an appealing doctrine, in part, because of its appeal to and its consonance with a bourgeois world in which the economic interests and ideas of the middle classes tended to prevail. Even if under capitalism socialists tended to be internationalist and pacifist, that provides no assurance that in a world of socialist states socialists would not be unqualified national patriots.

It may perhaps make what I have said more persuasive and more palatable to socialists if I quote from a prominent socialist, Harold Laski, who normally follows the strictest tenets of the faith to the letter, words to very much the same effect. It is true that Laski here takes a position quite different from his customary one. But on these matters Laski in conflict with his usual doctrines is much more persuasive than Laski consistent with himself:

A state is conceivable which is organized for the common welfare, in which the equal interest of men in its results is recognized as its essential principle. There is no a priori reason why such a state, if it were confronted by the prospect of a great addition to its common welfare, which it believed, for one reason or another, to be desirable or necessary, might not, if it thought the circumstances propitious, embark upon war in order to obtain that addition. It is even possible that such a state might embark upon war with a patriotism more extravagant, a loyalty more profound, than one in which its authority was exploited by a few. For the very fact that all citizens might share equally in the benefits expected would provide an incentive to victory far more intense than is likely in a state where these are confined to a small number of bondholders or a single industry battling for the domination of a market. The division of the world, that is to say, into a system of socialist states which retained the substance of sovereign authority would not, of itself, solve in a final way the problem of war. Until we recognize that an interdependent economic world, whatever the internal organisation of its constituent parts, is incompatible with a system of political units which bear no relation to that inescapable unity, we shall have left untouched the central cause of war.[6]

In the sixteenth and seventeenth centuries, writers on statecraft sometimes recommended to sovereigns resort to war as an effective means of diverting the attention of their subjects from their domestic troubles. As Dudley Digges put it in 1604: "forreigne warre [was] a sovereigne medecine for domesticall inconveniences." Even in the United States considerations of this sort have been said to have been a factor leading to the War of 1812 with England, and later, Seward appears to have advised President Lincoln to pick a war with some Euro-

[5] Lenin, *What Is To Be Done* (New York, 1935; written in 1902, p. 40).
[6] H. J. Laski, *op. cit.*, p. 502.

pean power selected almost at random on the chance that it would stop the sectional conflict between North and South from coming to a head. Socialists might perhaps argue that in socialist states there would be no "domesticall inconveniences" from which the peoples would need to be diverted by "forreigne" wars, but I am not aware that they ever have used this argument.

A somewhat similar argument, however, has in recent years been stressed by socialist writers. Readiness of peoples to go to war, they claim, is the result, indirectly, of general dissatisfaction with the economic conditions, with the poverty, unemployment, monopoly exactions, inherent in unplanned capitalist economies. War, they assert, also arises more directly out of the restrictionist tariff and trade policies of capitalist states seeking means of escape at the expense of other countries from depression and unemployment. Under socialism, and only under socialism, they argue, is there a real possibility of international collaboration to increase production and trade, and thus to provide an economic basis for friendly international relations.

The argument has been most systematically developed by G. D. H. Cole:

> . . . as long as national production is left unregulated, or is regulated only indirectly by means of tariffs and similar devices, there is no possibility of economic collaboration between States in any form which is not principally restrictive in its effects. . . . States cannot, save in very exceptional cases, come under present conditions to agreements designed positively to encourage trade between them except by taking measures definitely to exclude trade with some other country. Restrictive collaboration is possible, and does occur: direct planning for an increased volume of international trade is practically excluded under present conditions.

Economic planning under capitalism, however, cannot be expected to lead to nonrestrictive international collaboration:

> The danger is that, if a planned economy is introduced under Capitalism, it will become the prey of powerful vested interests, which will thwart the intention of promoting a distribution of the national man-power in the interests of the maximum welfare, and, instead of aiming at the conclusion with other national groups of agreements designed to encourage international exchange, will resume the imperialist policies characteristic of the later stages of capitalist development, and press these policies with the added strength derived from the closer relationship between the State and the economic order which national planning necessarily involves. If this happens, national planning, so far from serving as a force for the liberation of international exchange and the increase of world production, may easily turn into an instrument for the drastic restriction of both.[7]

Cole thus argues that national planning under capitalism is more likely to increase than to decrease the economic friction between nations. Using "national planning" to mean what Cole means by it, namely, the assumption by the state of a major role in the conduct of business and the substantial elimination of the free competitive market, I wholly agree with his conclusion, though not with his method of reaching it. But in fairness to advocates of extensive national planning on a

[7] G. D. H. Cole, *Studies in World Economics* (London, 1934), pp. 177, 183-184.

nonsocialist—i.e., nonequalitarian—basis, it should be pointed out that Cole does not present their argument that such planning, by promoting prosperity, would promote contentment and peace. The relationship between internal prosperity and international attitudes does not seem to me, either on a priori or on historical grounds, to be at all as simple or as one-directional as this, but I am not prepared to explore this important question further at this time. Cole unquestionably, however, would not claim for national planning under Naziism or under Fascism any greater peace-fostering tendency than for national planning under capitalism. What, therefore, is the peculiar aspect of socialistic economic planning which makes it, according to Cole, the sole economic pathway to peace? Here we encounter again the familiar argument that under socialism, and only under socialism, are there no special vested interests in aggressive foreign policy. Of the counter-argument that a nation unified by socialism might find a united national interest in aggression he makes no mention. Moreover, when he says elsewhere that "the economics of a planned world would resemble in the character and volume of international trade the imaginary world of the laissez-faire economists"[8] either he is thinking of a world planned as a unit without reference to national boundaries, or else he has failed to grasp the point that the trade relations between state-controlled national economies, whether socialist or not, would be governed not by the cosmopolitan competitive principles and the economic pacifism of the Manchester School but by the principles of duopoly and of bilateral monopoly and of the full exploitation of national power for national profit.

I have stated my reasons for believing that the extension of state control over national economies would, of itself, not be conducive to peaceful relations between nations, but, on the contrary, would make international economic intercourse, and national restrictions on such intercourse, a breeding ground for deep and dangerous international friction. I have argued that, insofar as, in the past, war has resulted from economic causes, it has been to a very large extent the intervention of the national state into economic process which has made the pattern of international economic relationships a pattern conducive to war. I have given reasons for expecting that socialism on a national basis would not in any way be free from this ominous defect. It may seem, therefore, that I have argued, in effect, that economic factors can be prevented from breeding war if, and only if, private enterprise is freed from extensive state control other than state control intended to keep enterprise private and competitive. This is my conviction, *for a world of autonomous nation-states.*

[8] G. D. H. Cole, *Principles of Economic Planning* (London, 1935), p. 282.

War, I believe, is essentially a political, not an economic, phenomenon. It arises out of the organization of the world on the basis of sovereign nation-states. Sovereign states will find occasion for friction and for war with other states in all the types of contact, and of state-suppression of contact, across national boundaries, economic and noneconomic. This will be true for a world of socialist states as for a world of capitalist states, and the more embracing the states are in their range of activities the more likely will be serious friction between states. If states reduce to a minimum their involvement in economic matters, the role of economic factors in contributing to war will be likewise reduced. Only, however, if mankind shall establish, or evolve, or have imposed on it, a world political order in which some form of world-authority will have the power and the will to restrain the activities of nation-states, whether economic or not, when they are such as to threaten the maintenance of peace, and perhaps also to enforce upon the nation-states positive action conducive to international collaboration, will mankind have any reasonable prospect of freedom from the recurrent threat of war. The greater the movement toward state control of economies, whether on a socialist basis or not, the more will this be true.

The emergence in recent years of nation-states which were certainly not free-enterprise states, which assumed the socialist label, and which conformed in their economic, if not in their political, organization much more to the orthodox socialist than to the bourgeois capitalist pattern, but which were avowedly and unashamedly advocates and practitioners of the use of national economic and military power for aggressive purposes, has brought even some socialists to the same conclusion. I have already quoted Laski to this effect. I will quote from another English socialist, Barbara Wootton: "the notion that you must get socialism first, after which all things international will be added unto you, is a notion which ignores the lessons of experience."[9]

There still remain the questions whether the extension of state control over national economies makes the establishment of an agency or agencies for world-government more difficult, and, given such agency, whether its prospects of effective life would be reduced by the increase of state control over the national economies of the member states. In general I am inclined to give affirmative replies to these questions. But I do not have strong convictions with respect to them and do not have at my command any objective technique for acquiring them. On these questions, I seek, but as yet have failed to find, light from the political scientists.

[9] Barbara Wootton, "Socialism and Federation," *Federal Tracts No. 6* (London, 1941), p. 13.

# INTERNATIONAL CARTELS AS OBSTACLES TO INTERNATIONAL TRADE

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An international cartel is an arrangement to avoid some or all forms of competition, the parties to which are business enterprises domiciled under more than one government and trading across national frontiers. Such a cartel may include the major enterprises which operate in a given industrial field throughout the world. But international cartels can operate upon a regional instead of a world-wide scale. Such a restricted cartel is possible if the areas which it does not dominate do not export the cartelized commodity or if the area included in the cartel is protected against outside competition by natural or governmental barriers. Moreover, concerns which sell throughout the world sometimes agree to limit their cartel activities to a region in which their interests can be reconciled while they continue to compete in other regions.

A substantial part of world trade before the war was controlled by cartels. Since 1939 the United States Department of Justice has instituted proceedings against 37 such arrangements having to do with petroleum, chemicals (including synthetic rubber, plastics, dye-stuffs, nitrates, and explosives), pharmaceutical products, photographic materials, electric light bulbs, fluorescent lighting equipment, magnesium, molybdenum, titanium, tungsten carbide, aircraft accessories and instruments, military optical instruments, flexible metal hose, and quebracho.

A tentative list of international cartel agreements which were in effect in 1939, prepared recently in this Department, contains a total of 179 such agreements, of which 109 included American enterprises. One hundred and thirty-three of these covered manufactured and semimanufactured goods; 32 covered minerals; 8, agricultural products; and 6, various services. In view of the fact that the Department of Justice contemplates further legal proceedings, it does not appear to be wise to be more specific as to the industries included in this list.

There are three general types of international cartels. One is the ordinary restrictive agreement among businessmen, in all its varying forms from a simple contract to fix prices or allocate sales to an international trade association which maintains an incorporated joint sales agency for its members. Another is the patents and processes agreement, in which two or more enterprises allocate national markets and control the terms of sale therein by means of a network of contracts governing the assignment and the license of patent rights which these enterprises have obtained under various national patent laws. A third is interlocking ownership, which may take the form of reciprocal exchange of stock

between large concerns, private stockholdings which establish a community of control among nominally independent enterprises, jointly owned subsidiaries, or the monopolization of an industry's international trade by a combination of concerns governed by a single holding company. Since the American antitrust laws clearly prevent straightforward price agreements, the cartels in which American enterprises have taken part have usually endeavored to operate under the cloak of the patent laws in the hope that their actions would thus become legal. They have also experimented with various forms of joint ownership designed to limit competition.

Whatever their scope or type, international cartels are designed to enhance profits by reducing competition. This aim is typically sought by a variety of means: direct price fixing; allocation of production, sales shipments, or trade territories in order to destroy incentives for price cutting; limitation of output in order to keep prices from falling; and measures intended to exclude nonparticipants from the market. Though some cartels undertake collateral activities such as the collection of business statistics, no cartel, so far as I know, is maintained merely or even primarily for such purposes.

The economic program of international cartels runs parallel to that of domestic combinations in restraint of trade. The central purpose is to maintain prices at levels higher than would otherwise obtain. The antecedent to a cartel agreement is often—but by no means always—a price war which may drive prices down to very low levels. Sometimes the low prices are symptoms of a declining industry or of a world-wide depression, but in other cases they are deliberately instituted as means to coerce rebellious elements in the industry to accept what the cartel group is willing to offer.

After the cartel is established, the level of prices is what the traffic will bear. New products which have a large potential market are frequently offered at progressively lower prices until a level has been reached which taps the potential demand, but thereafter further decline in price is likely to be slow and limited. When the organization of a cartel has been due to fear of recent changes in demand or in productive methods, the cartel price may be lower than that which prevailed in the industry prior to the changes, even though probably higher than that which would be appropriate to the new circumstances under competitive conditions. Sometimes cartelization makes it possible to take advantage of imperative needs for the product and to establish prices at high levels which deprive many would-be purchasers of the opportunity to buy.

The degree of stability established by cartel prices also differs in accord with surrounding circumstances. The most general form of sta-

bility is resistance to price reductions, even under conditions in which demand has fallen and plants and men are partially idle or in which new methods have reduced costs. Some cartel prices lag behind other prices during an upward movement, largely because, having resisted decline, they have fallen little and have little lost ground to recover. Other cartel prices, however, are raised from time to time, as often and as far as opportunity permits. In some industries in which control by the cartel is incomplete, periods of high prices have repeatedly induced an increase of productive capacity sufficient to break the cartel and bring about a precipitous price decline. The price fluctuations of such cartelized products as rubber, though infrequent, have been extreme and disastrous.

In spite of such variations, the typical purpose and effect of cartelization is to set prices higher than would prevail under competion, to reduce them as seldom as possible, and to raise them further whenever opportunity permits. The extremes to which prices may go under some cartel arrangements are indicated by the case of tungsten carbide, in which a cartel agreement between General Electric and Krupp drove United States prices from $50 per pound to more than $450, and the case of dental plastics, in which under the cartel a molding powder which sold for 85 cents per pound to commercial molders brought $45 per pound in sales to dental laboratories.

Though cartels are less often directly concerned with quality than with price, their necessary effect is to diminish the incentives to improve quality and to limit the opportunity for the buyer to protect himself against low quality. Sometimes the impairment of quality is deliberately undertaken. Under a cartel arrangement between du Pont and Nobel as to military explosives, a market was maintained for relatively unsatisfactory powder produced by Nobel by virtue of the fact that du Pont was bound to refuse the business of the dissatisfied customers. Under cartel arrangements concerning electric lamps, American manufacturers, protected from foreign competition, have attempted to increase their business by reducing the durability of their light bulbs, have sought by agreement to avoid comparative tests of quality, and have attempted to delay the use of the more economical fluorescent lamp for household purposes.

Restrictions of the available supply are prominent among the methods by which cartels undertake to maintain prices. Sometimes absolute limits are set upon the amount which may be produced, sold, or exported. This form of restriction obviously subordinates the consumer's demand for additional quantities to the industry's desire for additional profits. The tin cartel and the international steel cartel are examples of such activity. In each case, production quotas and export quotas were

used to limit the total supply, to determine the share of each producer, and thus to raise the price. In negotiations incident to re-establishment of the nitrogen cartel, a representative of du Pont had difficulty with a stiff-necked Dutch producer who disliked the idea of limiting production. The representative wrote:

> He claims very low costs and is determined to export that portion of his production (which to him apparently means capacity) which he cannot sell in Holland. . . . I used all the arguments you gave me and a few I thought up myself, but he is simply determined to sell his output.

Cartels which limit supply often attempt also to limit new industrial capacity. When existing capacity is partly idle, they may endeavor to exclude new enterprises which might reduce the prices and sales opportunities of established plants. Sometimes they try to delay the construction of efficient plants to replace obsolete ones. Sometimes they try to retard the development of substitute products which might reduce the markets for the older products. In the case of magnesium, American productive capacity was limited by agreements between the Aluminum Company of America, Dow Chemical Company, and I. G. Farbenindustrie, which provided for the closure of the Aluminum Company's plant in the United States in order to give Dow a monopoly, the exclusion of new competitors, a maximum limit upon Dow's production, and prices so high that even this maximum could not be attained.

A rigid control of research is a necessary part of the effort to limit new capacity. Cartel members often engage in vigorous research to maintain and extend their patent position, but use the resulting patents to fence in an industrial field in order that independents may not develop new processes or new products. Exchange of patents among parties to a cartel agreement broadens the use of particular inventions and makes a larger portion of the world's technology available to each participating concern than would have been the case had each used its own patents exclusively. But dominant companies such as General Electric sometimes discourage research by others, and concerns which are not admitted to the cartel are excluded not only from use of the patented technology which is employed by the cartel members but also from the technology which these members have been able to develop and keep out of use. Delay in the introduction of new processes by a cartel is peculiarly probable when an invention is fundamental in character and appears likely to bring about sharp reductions in demand or a rapid obsolescence of established productive processes.

The most prevalent devices used by cartels are the allocation of industrial fields and the allocation of national markets. By the former device, particular concerns are excluded from producing designated types of commodities, so that the control of the supply is left entirely in

the hands of one or more enterprises to which each kind of commodity is assigned. For example, I. G. Farbenindustrie and Standard Oil Company of New Jersey agreed in 1929 that I.G. would stay out of the oil business proper and Standard would stay out of the chemical business insofar as it had no bearing on the oil business. In pharmaceuticals, the allocation of fields was carried so far in Europe that by 1938 German and Swiss firms were agreed "that products which compete with the original products of members of the association and their subsidiaries or affiliated firms shall not be introduced in any country throughout the world."

By assigning national markets, cartel members mutually grant to each other monopolistic positions in areas which each regards as peculiarly valuable. Other portions of the world may be left open to all members of the cartel. The effect of such undertakings is to restrict investment abroad; to restrict exports not only by cartel members but also by their customers who are required to observe the territorial restrictions; and to withhold imported commodities from consumers in the monopolized markets. When United States enterprises participate in such restrictions they usually reserve for themselves the United States market, or perhaps the North American market, and in exchange for monopoly here agree that they will abstain from exports to Europe or to all the rest of the world. In certain important cartelized industries the predominance of German over United States exports in Latin-American markets before the war was due primarily to territorial agreements which assigned the Latin-American market to German concerns.

Such programs of price maintenance, impairment of quality, restriction of output, restriction of expansion and invention, and allocation of fields and territories, carried out upon an international scale, necessarily have a bearing upon the policies of national governments. Insofar as national states are agreed in promoting a larger international trade and in removing barriers to it, the policies of international cartels run counter to national public policies. The trade restriction of the cartel is the opposite of the trade promotion sought by governments. The territorial allocation of the cartel is the equivalent of the tariff wall which governments seek to reduce.

However, the relation of cartel policy to national policy is often more complex. National states, like cartels, may desire to restrict trade. But whereas cartel restrictions are intended to serve the interests of cartel members throughout the world at the expense of outsiders, the restrictions imposed by national states are intended to serve interests in a particular country at the expense of interests in other countries. Thus cartel restrictions often conflict even with national

restrictions, and a cartel cannot readily become an instrument of restrictive national policy in one country unless it is also a means of attack upon the national interests of other countries. A cartel may express a collective national interest of producing countries in the exploitation of consuming countries; but since cartels are international, they might be expected to resist subordination to a particular producing country's national policy. There is reason to believe that many of them do so. However, when a cartel is dominated by the enterprises of a single nation, the economic control expressed in cartel policy may take a political form as well, so that the activities of the cartel supplement and reinforce the activities of the national state in which the dominant concerns are domiciled.

The opportunity to use a cartel for national ends is increased if one nation's participating enterprises are politically-minded, whereas those of other nations are concerned primarily with their business interests. In democratic states with a tradition of business freedom from governmental control, businessmen are likely to follow their own line. In states in which the distinction between business and government has been progressively obscured, the use of business enterprises to accomplish political ends is both easy and natural. In general, American concerns have been unaware of or indifferent to the political significance of their acts, but have taken part in cartels for business reasons. They have believed, with the Chairman of the Board of General Motors, that "an international business operating throughout the world should conduct its operations in strictly business terms, without regard to the political beliefs of its management or the political beliefs of the country in which it is operating." German concerns, on the contrary, have often accepted the guidance of their government even when profits were thereby impaired. Many of them have agreed with the Chairman of the Board of the Osram company that "an international cartel has no right of existence and a German businessman has no right to become a member of such a cartel if this cartel is acting against the common interests of Germany."

The dual role of international cartels appears clearly in the field of commercial policy. Business-minded cartels develop their own programs of trade restriction, which may run counter to the policies of national states. The agreement between du Pont and Imperial Chemical Industries, for example, recognizes the United States market as the exclusive territory of du Pont for patented products and the British Empire, with certain exceptions, as the exclusive territory of I.C.I. Since I.C.I. controls almost the whole chemical industry of Great Britain and in practice the agreement governs almost the entire line of chemical products, both patented and unpatented, the agreement

is the practical equivalent of a prohibitive tariff upon the importation of British chemicals into the United States and serves to exclude a substantial portion of American chemicals from most of the British Empire. Before the war, the quinine cartel controlled the United States market by preventing American manufacturers from making from cinchona bark more than half of our domestic requirements of quinine and by forbidding them to export any of it.

Business-minded cartels make substantial efforts to induce governments to adopt public trade restrictions which supplement the private ones. They desire tariffs to give protection against independent enterprises and to improve their own bargaining power in dealings with other cartel members. Sir Alfred Mond, organizer of Imperial Chemical Industries, wrote in 1927:

> In negotiation, the man behind the tariff wall always has something with which to bargain, which the man in the Free Trade country has not. Any one who has any practical experience of bargaining with continental producers knows that the first thing they say is: "You cannot export to our country, because we have a tariff. How much of your market are you going to give us?"

Politically dominated cartels, on the other hand, become instruments of the commercial policy of particular governments. In the period between the two wars, some cartels were used by the German government to maintain German exports and supplies of foreign exchange. For example, I. G. Farbenindustrie and Sterling Products had an agreement as to the marketing of pharmaceuticals in South America by which supplies were to come from the company which could furnish them at lowest cost. At first I.G. was the supplier. In 1934, it became evident that Sterling could deliver cheaper, but I.G. insisted upon retaining the market. Though Latin-American and German exchange restrictions caused inconvenience and loss of profits to both companies, Sterling was unable to persuade I.G. to surrender the market because, as a Sterling official remarked, "the government would hop on them immediately."

Both the business-minded and the politically-minded industrial cartels usually follow policies which conflict with the aspirations of the governments of nonindustrial countries regarded by cartels as colonial markets. Such governments typically desire the industrial development of their own countries. In recent years such aspirations have been encouraged by the United States through its participation in development commissions and its financial aid for development projects in Latin America. Cartels, however, resist the rise of new enterprises abroad as well as at home. Efforts by Latin-American governments to encourage domestic soda ash production have been met by temporary price cuts, dilatory action to conduct so-called "exploration of possi-

bilities," and efforts to discourage independent projects. Imperial Chemical Industries wrote to a cartel partner in 1940:

> We should like to make it clear that our object when we considered the manufacture of soda ash in Brazil was primarily to control or preserve our present joint control of the market and to safeguard your as well as our future import business. It was for this reason that we intended to limit the size of the projected plant to 20,000 tons.

The activities of the politically-minded cartel also raise serious problems of security for national governments. After the Nazi Government came into power in Germany, cartels were extensively used for trade penetration, political propaganda, collection of information about foreign industries, and efforts to suppress the development of strategic industries in areas which might be hostile to Germany. In Latin America, I. G. Farbenindustrie and Sterling Products used their advertising as a political weapon to punish anti-German newspapers and reward newspapers favorable to the Nazi cause. Cartel connections were used to obtain information as to industrial developments outside Germany which might be of military importance, while at the same time German cartel members were prevented by their government from transmitting strategic information abroad. Cartel arrangements prevented or limited the production outside Germany of some of the most important new materials of war. These restrictions were necessary consequences of policies of limiting output and capacity and suppressing technology such as are characteristic of cartels, but it appears that in certain cases ordinary monopolistic purposes were supplemented by deliberate military planning on the part of the German authorities. The cases of synthetic rubber, magnesium, beryllium, and military optical instruments are well-known examples.

If postwar policy is to be devoted to promotion of world trade, expansion of production and increase in living standards, development of colonial areas, and curbing of politico-economic nationalism, there is no place in it for restrictive private cartel practices. Our own Congress enacted the Dewey amendment to the Trade Agreements Act without a dissenting vote after its author had described it as a categorical repudiation of the cartel system. Abroad there is active public discussion of postwar policy toward cartels, and the most earnest advocates of cartels have conceded that such bodies should be checked by requirements that their agreements be made public or be explicitly sanctioned by governments. Nevertheless, there is a substantial propaganda for extension of the cartel system under a minimum of public supervision.

It is to be hoped that restoration of peace will be accompanied by agreed international action to use public policy against barriers to trade, both governmental and private. However, if such a policy should

not prove to be feasible, the question must be faced whether the United States can protect its interests against cartel restrictions by independent action. This question is all the more urgent because national and international business combinations are intimately related and the task of any country in keeping its own markets free must be more difficult if the world markets beyond its borders are monopolized.

Unilateral action against cartels is obviously feasible in cases in which cartels cannot exist unless American business enterprises participate. In the domestic market of the United States direct action can be taken to keep American firms independent. If such enterprises produce all or most of the domestic supply, cartelization of the market from abroad is impossible. Even if a substantial portion of domestic requirements is filled from abroad, a foreign cartel cannot easily achieve control if there are large American exports which could be diverted to the home market or if the American producers can readily expand their output.

If the rest of the world depends upon American producers for a substantial part of its supplies, the policy of the United States toward American exporters may also do much to determine whether cartels can be successful in the foreign markets of the United States. Present American policy toward export markets, as expressed in the Webb-Pomerene Act, permits united action by exporters on condition that they neither restrain trade in the domestic market nor impose restraints upon independent export interests. In practice some American business groups have interpreted this statute as authorizing them to join international cartels, but where the cartel arrangement limits the export opportunities of American nonmembers or imposes any restraint upon American domestic trade the interpretation is obviously erroneous. Hence in practice the Webb-Pomerene Act does not often sanction joint action by American and foreign enterprises to cartelize foreign markets.

Unilateral action against cartels is more difficult in cases in which the American market depends upon foreign sources of supply. Some commodities are produced wholly abroad: for example, tin, nickel, cinchona bark, quebracho, industrial diamonds and gem stones, natural rubber, and natural nitrates. Other commodities are available domestically, but since home production is insufficient and cannot be readily increased, the foreign supply is indispensable. The extent of the control which foreign producers enjoy in such cases depends upon the proportion of imports to domestically produced consumption and upon the ease with which further supplies or substitutes for domestic use may be obtained from domestic sources. In some instances, for example nitrates and rubber, the availability of domestic synthetic substi-

tutes reduces the authority enjoyed by foreigners who control the natural product. In the extreme case, the domestic market is wholly at the mercy of foreign cartel policies.

Direct efforts to assert authority over the foreign enterprises which control supplies needed in the American market can accomplish little if it is possible for those enterprises to conduct their business in such a way as to deprive the American Government of jurisdiction over them. For example, if foreign cartel members operate through American branches, they may become subject to legal proceedings under the antitrust laws. In consequence, some cartels seek to avoid acquiring an American domicile and surrender title to their products beyond the American border, in the hope that thereby they can escape the jurisdiction of the United States courts. The greater our zeal in proceeding against cartel practices, the more careful such foreign groups will be in their efforts to remain beyond the reach of the authority of the American Government. If they succeed, present laws will be ineffective.

Possibilities of unilateral action in such industries as these may perhaps be found in control over importation of goods and export of funds, in authority to withhold from foreign offenders governmental grants of privilege such as the issuance of patents or the recognition of trade marks, in pressure which it may be possible to exert upon foreign concerns through their home governments, and in governmental and private action designed to make the American market less dependent upon the cartelized product. The extent to which such action may be desirable is, of course, still unexplored. The degree of success attainable by such measures is likely to differ from case to case.

In summary, it appears probable that by preventing restraints in international trade by domestic concerns the American Government can render international cartels powerless in American domestic markets except for a relatively small number of commodities which are primarily foreign in origin. To varying degrees, foreign cartels may be induced to modify their restrictions upon commodities which the United States imports by special measures such as the development of domestic substitutes. The effects of foreign cartels in burdening export activities of independent American exporters can be weakened by preventing Webb-Pomerene associations from going beyond the limits imposed by law, and perhaps also by pressures similar to those available for use in coping with cartelized imports.

# A POSTWAR COMMERCIAL POLICY FOR THE UNITED STATES

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Our postwar commercial policy, like all postwar policies, will be compounded of old and new elements. The statutes and administrative regulations which controlled our prewar trade have been superseded temporarily by wartime controls, but they have not been repealed. They still form the foundations of our commercial policy, although at present overlaid by a mass of regulations designed for economic warfare. Likewise the fundamental, or perhaps I should say "fundamentalist," protectionism of large sections of the American public has been temporarily submerged by the wave of wartime co-operation with our allies; we are partners now, not competitors, with the Russians, the British, the Chinese, the Australians, and the Canadians. But what lies ahead? What will be the shape of our policy in postwar years? How far will prewar institutions and prewar attitudes regarding foreign trade serve our national interests in the new postwar conditions? How much of the wartime regulations and wartime philsophy should we carry over into the peace? What new institutions may be necessary to serve American interests? These are the questions to which I shall address myself in this paper.

## I

Let us have a look, first, at the prewar foundation stones. There are five of them:

1. *Rigid and uncompromising protectionism.* The rates of duty fixed in the Hawley-Smoot Tariff, which capped the climax of a seventy-year upward trend, were not substantially reduced in the thirty-odd trade agreements negotiated since 1934. We built our tariff wall high, and we plugged all the loopholes by a detailed system of administrative regulations which were rigorously enforced.

2. *Equality of treatment.* Our tariff policy was hard-boiled, but we played no favorites. Except for Cuba and certain tariff quotas, our import duties and other restrictions applied to all countries without discrimination.

3. *Tariff autonomy, a basic principle.* The bulk of the rates which compose our intricate tariff structure are those fixed by Congress, acting with little or no regard for their possible effects on world trade, or on economic conditions outside the United States. Only since 1934 has the President had the power to modify rates by tariff bargaining.

4. *Encouragement of exports.* With lavish appropriations we made

available to exporters a marvelous market service. Making practically no use of outright export subsidies, we accomplished the same purpose by our gold purchasing policy.

5. *Free enterprise.* The decisions of private traders rather than government officials determined the volume and the direction of our foreign trade. We had no government monopolies of imports or exports.

## II

This is not the place for a detailed description of wartime policies. Perhaps the best way to understand them is to stand our traditional policy on its head. Nothing is now imported or exported except after consideration of the bearing which the transaction may have on the war effort. Government-owned corporations bring in about one-fifth of all the foreign goods received. Exports to the extent of four-fifths of the total are Lend-Lease transactions undertaken on government initiative for government account. The remaining fifth, however, is not "free trade" in the prewar sense, for private exporters may ship only on license to approved customers and to approved destinations. The decisions of policy which affect exports and imports are not taken by our government acting alone, but in close consultation with the British, the Canadians, and other allied governments. Thus it appears that the wartime control of foreign trade exhibits characteristics which are directly opposed to those with which we had become familiar in peacetime.

Private trading has been replaced by government trading. Equality of treatment was abandoned as soon as trade control became a weapon of economic warfare. In fact, in the war economy the phrases equal treatment and discrimination have lost their usual significance. Finally, the effect of the war has reversed our traditional attitude toward imports and exports. Prewar protectionism was based on the assumption that imports of competitive goods were dangerous to the American economy, and that they must be therefore kept at a minimum. Furthermore, the definition of "competitive" was constantly expanding. Large exports, on the other hand, symbolized prosperity. This was a logical philosophy for an economy constantly threatened by deflation, depression, and unemployment. But the war has given rise to exactly the opposite set of conditions—to scarcity of goods and of manpower, and an abundance of liquid funds. These are the conditions which have made larger imports seem desirable; they are the logical basis for the restriction of exports.

## III

Which shall prevail after the war—the old or the new? Shall we make a clean sweep of the wartime controls and wartime thinking,

bringing back into effect our protectionist institutions in all their prewar vigor? Or shall we not rather make the most of this exceptional opportunity to review our traditional policy? Shall we not plan to reshape it so that under the new postwar conditions it may better serve the national interest, both immediately and in the long run?

Advocates of getting back to normal promptly have already made their views known. Spokesmen for the Industrial Conference Board, the National Association of Manufacturers, the National Foreign Trade Council, and the United States Chamber of Commerce all have argued for a rapid demobilization of foreign-trade controls and for the resumption at an early date of trading through the channels of free enterprise. Protected interests are warning of the necessity of maintaining tariff barriers, and even raising them. All this is part of the general urge to make as quick a transition as possible, in domestic as well as foreign trade, from a war economy to a peace economy.

While agreeing that the aim of policy should be to restore, eventually, a very large measure of private enterprise in the field of foreign trade, economists are inclined to be more cautious regarding the speed at which the transition should be made. This caution results partly from common sense and partly from the study of the disastrous results which followed rapid demobilization of economic controls after the last war.

History, of course, never repeats itself exactly, but authoritative opinion seems agreed that the immediate danger confronting our economy at the end of this war will not be nation-wide business depression, but rather a runaway price inflation similar to that which occurred in 1919-20. In fact, inflationary forces may prove more explosive than they were twenty-five years ago.

If this analysis is correct, and I assume that it is, the retention of controls over domestic business in the immediate postwar period will be necessary as a safeguard against inflation, and it is inevitable that we should also retain for a considerable period some of the wartime restrictions imposed upon import and export trade. We should look upon the transition period as in many respects a prolongation of the war economy in which wartime policies are to some extent still appropriate. One cannot imagine rationing electric refrigerators in Des Moines while allowing exporters to ship them in unlimited quantities to Rio. If scarce raw materials are allocated to domestic manufacturers, some determination of the proportions of their production which are to be sold in domestic and in foreign markets will be necessary. In the case of exports, consideration must also be given to the needs of relief and rehabilitation agencies.

We may also need to continue government purchasing of certain

imports for two purposes: (1) to aid in the maintenance of domestic price ceilings, and (2) to carry out our pledges to Latin-American countries that we would cushion their transition to a peace economy.

In choosing a policy for the transition period we shall need to continue the practices of consultation and joint action which have been developed during the war with the United Kingdom, Canada, and other countries in the fields of shipping, food, and raw materials. We must, of course, avoid using our controls in such a way that we divert inflationary tendencies from our own economy to that of some other nation.

When the time comes for the relaxation and removal of various wartime controls, agreed action will again be important. Our exporters now complain that, while their shipments are restricted, the British are taking advantage of the situation to entrench themselves in the Middle-Eastern and Latin-American markets. Such complaints will be greatly amplified when the war ends. Similarly, the danger may arise that large purchases by American government agencies would conflict with the import operations of the private traders of other countries.

## IV

We should remember constantly that the years immediately following the war—the years which we conveniently label as transitional—are in effect just that; the policies which we adopt for that period are temporary devices for bridging the gap or easing the process of adjustment, and particularly for coping with the threat of inflation. Obviously, we must also devise policies of a more permanent character, suitable to protect American interests and realize American objectives when that danger has passed, when we have accomplished the transition to more settled conditions. Moreover, by framing long-run policies now and proclaiming them, we may be able to shorten the period of transition.

Broadly stated, the long-run interests of the United States will not have been changed by the war. Still our major concerns in the field of international economic relations will be the preservation of peace and the expansion of mutually beneficial international trade. Reduction of tariffs and removal of other trade obstacles are not the sole, nor perhaps the most significant, means of accomplishing these purposes. Reduction of our tariffs will not help very much in promoting the industrialization of China. We need to build up the purchasing power of backward countries by large-scale investment of capital. We shall certainly need also a multilateral agreement for exchange stabilization. But the expansion of international trade will be a necessary condition

for making these other methods effective. Hence the importance of framing an American commercial policy which will substantially enlarge the volume of world trade. Our problem is not the formulation of new objectives for American policy but rather devising means more effective than those already at our disposal for meeting objectives traditionally American.

The Hull Trade Agreements Program—the only instrument of American commercial policy now available—seems to me inadequate for the new task. Eleven years ago at the annual meeting of this Association, in December, 1932, I advocated that the United States adopt a policy of tariff bargaining. Bargaining, I thought, might set in motion a series of concessions by a large number of countries, and thus decisive action by the United States might break the world's tariff jam. For a few years it looked as if those results might be attained. The long upward trend in American tariffs was checked, and in a few of the more important agreements, particularly those concluded with Canada and the United Kingdom, significant reductions were made on both sides. But the impartial observer must admit that the thirty agreements concluded to date have not accomplished a real reform in the American tariff; consequently, their effect on foreign tariffs also has been limited. The agreements were effective in stimulating exports, but their effect on our import trade seems to have been negligible. Hence they tended to aggravate, rather than correct, the distortion in our balance of payments. This statement is intended as no reflection on the abilities of the staff of experts who worked on the trade agreements. They were not responsible for ultimate decisions on policy. They were not given the green lights by the political traffic officers which would have permitted real progress on the road to tariff reduction.

Our export surplus threatens to become in postwar years a serious obstacle to the stabilization of currencies, to the general adoption of liberal trading policies abroad, and to the expansion of international trade. Already in prewar years our tendency to export more in the way of goods and services than we imported had created a troublesome shortage of dollars. That shortage, according to a recent official report, threatens to become more serious after the war, for both imports and exports will probably exceed in total value the prewar figures, but the forces stimulating exports will be "different from and stronger than those determining imports."[1] The report stresses the dominant effect which domestic business activity exerts on our imports of foreign raw materials. But even assuming full employment in American industry, it predicts that our purchases of this class of foreign goods will

[1] *The United States in the World Economy* (Bureau of Foreign and Domestic Commerce), p. 16.

not increase fast enough to provide sufficient dollar exchange to balance our accounts. It finds that imports of some finished manufactures demonstrate a capacity of rapid increase in times of prosperity, but since the variety of such goods has been severely limited by the tariff, they do not figure largely in the total value of imports.

An obvious remedy for this situation is the reduction of the American tariff on finished manufactures. In recent discussions it has often been assumed that such goods have a low price-elasticity, but as far as I am aware no satisfactory statistical proof exists of this assumption. Deductive reasoning, on the contrary, would seem to lead to the conclusion that since such goods are largely luxury articles, their sales in the United States would increase rapidly when prices were lowered by the reduction of import duties. It is my contention, however, that the Hull Trade Agreements Program offers no adequate means of accomplishing on a sufficient scale the cut in American import duties.

Furthermore, the process of bargaining turned out to be slow and cumbersome. Ten to twelve months appear about the normal time necessary to complete an agreement, even after preliminary conversations have been concluded. The practice of generalization of concessions, moreover, makes it difficult—in some cases entirely impracticable—to conduct negotiations simultaneously with several countries whose economies are similar, for none of them will grant concessions in exchange for a tariff favor if by waiting until negotiations with other countries were completed it might secure them for nothing. Hence, in practice, bilateral negotiations involve treating with each important trading country successively. But the pressing needs of reconstructing a war-torn world economy will not allow us to deal with commercial policy in this leisurely fashion.

Apart from the question of time, the bilateral approach seems ill-adapted to the problems of the postwar world. We have already recognized, or are in the process of recognizing, that the stabilization of exchange rates, the development of industrially backward areas, and the stabilization of prices of primary commodities cannot be dealt with effectively through negotiations between pairs of countries. It is time that the same principle was applied in the field of commercial policy. The aim of American policy, repeatedly expressed, has been the development of international trade on a truly multilateral basis. For that purpose, only multilateral agreements are adequate.

This view rests not only on formal logic and common sense; it can be supported also by examination of some of the outstanding problems of postwar trade. Let us take, first, the problem of making the transition in the postwar period. As I have already pointed out, many of the wartime restrictions on imports and exports must be retained

in this country as safeguards against inflation. In others, for example in the United Kingdom, deflationary tendencies may require the continuance of drastic restrictions on imports and aggressive pushing of exports. No country will want to retain its restrictive policies, but none will dare to move to liberalize its policy until it knows what others will do. This is the situation which it seems to me can be handled satisfactorily only by a multilateral agreement. We dare not risk the delay inevitable in the bilateral process. There is too much danger that what was designed to be transitional will become permanent, and that our economies will adapt themselves to a condition of restricted trade and a large measure of government intervention.

Take another example: the problem of finding a solution within the framework of multilateral trade for the acute problem of bringing the British balance of payments into equilibrium. In brief, the British problem is how to find the means of paying for postwar imports. Britain will emerge from the war with substantially reduced foreign assets, with a depleted merchant marine. Its income from tourist expenditures will probably not equal prewar figures. The loss of these invisible exports, alone, will create a gap in the balance of payments, perhaps of the order of 200 million pounds per annum, which must be closed in the long run either by restriction of imports, or expansion of exports, or both. Even with imports severely restricted, the necessary increase in British exports would be perhaps 750 million pounds, or 3 billion dollars at present rates of exchange.[2]

The British disequilibrium is not a war phenomenon; it was responsible for the abandonment of free trade in 1931-32; it was a powerful factor in framing the Ottawa Agreements and in the negotiation of bilateral clearing arrangements with Argentina and other countries. Foreseeing that the disparity between payments and receipts on international account will be widened by war disturbances, thoughtful Englishmen are considering a variety of solutions, ranging all the way from the continuance of exchange control and bilateral trading to completely planned foreign trade. Rigorous protection of English industries by tariffs and the division of foreign markets by cartel agreements are features of some of the plans under consideration. It is obvious that in their essence all of these devices are restrictive of the international trade; furthermore, their tendency is to limit the area open to free enterprise in the field of foreign trade. On both these counts, they are antagonistic to the proclaimed objectives of American policy. The measures proposed are distasteful to many British business leaders and economists, particularly those of liberal traditions, but they see no

[2] See "Britain's Balance Sheet," *Fortune*, December, 1943, 221; also, Geoffrey Crowther, "Freedom and Control," *Foreign Affairs*, January, 1944, 183.

other way out. Their standard reply to criticism from this side of the water is: "Reduce your tariff, give us a wider market for our exports, and we shall be in a position to adopt more liberal policies."

The point seems well taken, but even a casual examination of trade statistics shows that American action would not be enough. Even in a good prewar year—1937, for example—our markets absorbed only 200 million dollars of English goods, or 6 per cent of the total exports of the United Kingdom. Even if we doubled our 1937 purchases, which is far more than we might expect as the result of a bilateral tariff agreement, that would be far from absorbing the necessary increase in British sales. Obviously, Britain needs wider markets than we can supply. Liberal investment of capital would help British sales in industrially backward countries, but their largest markets are in industrial countries. The most effective method of opening those markets would be a multilateral agreement to reduce tariff barriers.

Russia will emerge from this war as the dominant country on the European Continent, in a political and military sense, and potentially a great industrial nation. The development of Russian economic power, which in a large degree has made possible its military victories, has astonished the world. How will Russia use that power? Several alternative policies are possible. Her great wealth of natural resources would put her in a better position than almost any other nation to practice a policy of national self-sufficiency. It seems more likely, however, that Russian leaders, intent upon rehabilitating Russian industry, continuing the process of industrialization, and at the same time raising living standards, will reject autarchy in favor of active participation in international trade. The adherence of the U.S.S.R. to the Atlantic Charter and the signing of Article VII of the Master Lend-Lease Agreement seem to point to this conclusion.

But Russian trade may raise serious apprehension in countries whose trade policies are still based on principles of free enterprise. The appearance of a large volume of Soviet exports in their markets may well give rise to charges of dumping, with perhaps the application of penalty duties. On the other hand, in free economies associations of exporters may demand monopoly powers in order to equalize their bargaining power with that of Russian purchasing commissions. Such devices obviously would tend to restrict rather than expand the volume of international trade. They are the devices of economic warfare which we and other peace-loving nations are striving to eliminate.

For this baffling problem there is no ready-made solution. Certainly, the Trade Agreements Program furnishes none. Its scheme for an expansion of international trade by means of reduction of tariff duties and removal of restrictions and prohibitions is premised on agreements

between a pair of liberal economies, each of which generalizes its concessions in accordance with most-favored-nation pledges. But neither import duties nor most-favored-nation pledges have real significance in a planned economy in which all foreign trade is conducted as a government monopoly. Recognizing this fact, the United States has made a special type of agreement with Russia, by which the latter, in return for most-favored-nation treatment, agrees to a stipulated minimum annual purchase of United States goods. The agreement is to a certain extent a protection against gross discrimination against American exports, but it may require Russia to discriminate against other markets where it could purchase certain items to better advantage. Also, the minimum purchase agreement contains no protection for American producers against ruthless Russian competition in our markets. We could, of course, retaliate with antidumping measures or with countervailing duties, but these are designed for use against free economies; their definitions run in terms of costs and prices. And yet it seems desirable that our trade with Russia, and that of other liberal economies, should continue and should increase. For the world has much to gain from the full utilization of Russian skills and Russian resources.

Here again is a problem which might find its solution in a multilateral agreement in which both free and planned economies would participate. It should construct new definitions of unfair competition applicable to the new conditions of trading. One feature might be a guarantee on the part of the planned economy to maintain its global imports at a figure not less than a specified proportion of domestic production. Supplementing this should be a pledge to base its purchases and sales on ordinary commercial considerations. Each free economy, on its part, should undertake not to apply antidumping or other penalties to imports from a planned economy, unless such imports threatened serious injury to some well-established domestic industry.

Regional tariff arrangements, including under this phrase preferential tariff systems as well as complete customs unions, will raise troublesome questions of commercial policy in the postwar world. Small countries, particularly, will seek protection within the framework of larger economic units. They will want access to larger markets, and other advantages, political as well as economic, which can be had through closer association with their neighbors. Groupings of this type have often been suggested as a remedy for the disturbed conditions in Central and Southeastern Europe. In South America a movement for preferential tariff rates, involving Argentina, Peru, Uruguay, Paraguay, and Bolivia, has arisen out of wartime emergencies.

But the formation of such regional arrangements must depend in large measure upon the attitude taken by the great trading powers.

The United States has taken a liberal attitude in its trade agreements with Argentina, Peru, and Uruguay, in which we renounced the benefit of tariff preferences which they granted to neighboring countries, but the principal European nations hesitate to follow our lead. Now, it is evident that the unwillingness of a single large country to give up its rights to most-favored-nation treatment would, in effect, make the arrangement impossible. By canceling the grant of most-favored-nation treatment to the members of the proposed union, it might deprive them of more important trading advantages than they would gain by the new arrangement. The effectiveness of this threat was demonstrated in the failure of the Ouchy Agreement in 1932 because of the uncompromising attitude adopted by the United Kingdom.

Not all regional arrangements can be justified from the point of view of an expanding international trade; in fact, the presumption is probably against them. But the decision as to which are desirable should not rest with a single nation. What is needed evidently is a judgment by a qualified international body which, after examining the constitution of the proposed tariff arrangement, would condemn or approve it according to its probable effects on the structure of production and on the flow of trade both inside and outside the region. The establishment of such an international body obviously can only be accomplished by a multilateral agreement.

## V

The substance of my proposal is this: The United States, the United Kingdom, Russia, China, Canada, and other countries associated in the war against the Axis powers, building on wartime habits of economic co-operation, should at once proceed to the formation of a comprehensive agreement on postwar commercial policy. Although for convenience originating among a limited group, the agreement should eventually be open to all countries of like mind, vanquished as well as victors. The founding states should pledge themselves to undertake at once (1) the reduction of protective import duties; (2) the abolition of quantitative restrictions on imports, such as licensing systems and quotas; (3) the removal of outright prohibitions and restrictions on imports and exports; (4) the elimination of all types of tariff discriminations; (5) the abandonment of export subsidies and the suppression of all types of unfair competition in foreign trade.

Each of these five basic pledges would need elaboration and qualification. Probably, the reduction of tariff duties should be undertaken gradually, proceeding toward a maximum level agreed upon in advance. In some cases—for example, in trade between a liberal and a planned economy or between two planned economies—quotas might be justified

as a means of facilitating an expansion of trade. Some types of prohibitions of imports—for example, to protect public health and the health of animals and plants—should be retained, but they should not be used as measures of concealed protection. Moreover, it should be recognized that the need for removing trade obstacles applies with particular force to the older highly industrialized states; consequently, it may be desirable to grant exemptions to newer communities, those which are only beginning to introduce manufacturing and which may find protective import duties temporarily useful. Discriminatory tariffs will need to be defined, particularly with reference to the various types of regional tariff arrangements which may be formed after the war. The agreement to suppress unfair competition will be useless until a code of rules has been framed.

These remarks lead to the conclusion that all five of the pledges which I have expressed in general terms will need to be qualified; the obligations which they impose must be made more precise. But even if drafted with the greatest skill, they will not supply formulae which will automatically fit every situation. Hence the five basic agreements must be supplemented by a sixth, an agreement to establish an international agency which might be called the "International Trade Commission." Multilateral agreements are legislative in nature. In order that they shall be effective, they need a judicial body for their interpretation, such as the Permanent Court of International Justice, and also an administrative agency with appropriate powers and duties. The Universal Postal Union has its International Bureau. The labor provisions of the Treaty of Versailles are administered by the International Labor Office. These and other instances which could be cited furnish precedents for an International Trade Commission.

The functions of this commission should be both research and administration. On the research side, the commission's experts should be engaged continuously in studying the possibilities of the most effective utilization of the world's resources through a steadily expanding volume of international trade. The second major division of their research work should be the examination of the effects of commercial policies, tariffs, customs administration, and all legislative or administrative measures which restrict or regulate imports and exports.

On the administrative side, the commission's duties should include consultation with local tariff-making bodies, particularly with respect to exemptions from the general obligation to reduce customs duties. For example, a country facing extreme difficulty in reaching equilibrium in its balance of payments may find it necessary to impose drastic restrictions on imports. The remedy for such situations may be found in

the operations of an international exchange stabilization fund. If not, the country concerned should be under obligation to consult the trade commission before imposing new restrictions on import trade. Another example. Industrially undeveloped countries in which new manufactures have been established during the war will wish to use import tariffs to protect their "infant industries." Ideally, it might seem desirable that the trade commission should have the power to veto increases in tariff rates which it disapproved, or additional restrictions on import or export trade. But in every country, and particularly in those where new industries were developing, the general national sentiment and the pressure of special interests would reject this idea. Hence consultative and advisory powers seem more appropriate. The multilateral agreement should provide that countries proposing new restrictions on imports should first submit them to the commission for examination. It should seek to determine (1) whether the new enterprises to be established would be reasonably sure of surviving with the aid of moderate protection; (2) whether their establishment would result in diversification of industries along lines economically and socially desirable; and (3) whether state aid might not be better applied by some alternative method; e.g., by subsidies to producers.

The commission should then issue a report of its findings showing the probable results of the proposed changes on the trade and industry of the initiating country and of other countries. Since the commission would have no power of veto, the state would not be forced to follow its advice or its recommendations. But a carefully prepared report by a commission composed of persons of acknowledged ability and high prestige might have educational and moral value strong enough to check or modify tariff policy while in process of formation.

The commission should supervise the operation of all bilateral trade agreements as well as the multilateral agreement here proposed. The commission should interpret the agreements, at least in the first instance, ruling upon disputed points. Its decisions might in some cases be subject to review by the Permanent Court of International Justice. The question then arises: How could the commission enforce its decisions? What sort of sanctions could it apply?

The mere knowledge that the fact of violation could be determined and published by the commission might have some deterrent force, but in addition it should be provided in the multilateral agreement that a country which failed to fulfill its obligations should be deprived of all rights to most-favored-nation treatment. A recommendation from the commission should be sufficient to free any signatory country from its obligation to afford equal treatment to a recalcitrant.

## VI

Standing alone, looked at as an isolated experiment in international co-operation, the proposal that the leading trading nations of the world might be brought to agree to abandon quantitative restrictions on imports, to give up bilateral trading, and to reduce tariffs might well be condemned as fantastic. Critics, pointing to the efforts of the League of Nations in the twenties and early thirties, would say with reason that reforms of this sort had been tried before—and they did not work. But it should be recognized that the setting now is different, and much more favorable to concerted action in the field of commercial policy. If we act now, we can build on an experience of wartime co-operation in trade policy. More important is our present awareness of the necessity of setting up now, before the war ends, a number of institutions for political and economic co-operation. We are now aware that the attack on postwar problems must be made along the entire front. Currency stabilization, capital investment, the control of prices of primary commodities, and the reform of commercial policies are not isolated problems; they are parts of the general problem of economic reconstruction and economic development. All of them being interlocked, none of them can be solved unless means can be found to establish political security, to guarantee freedom from the fear of aggression. Out of the association of the United Nations in this war will come some sort of arrangement designed to maintain peace. Discussions have already been initiated of a United Nations stabilization fund, a world bank for capital investment, an international commodity corporation, and a general economic board designed to integrate their operations. Furthermore, with these new political and economic institutions in operation, two persuasive arguments for continuing protectionism as a national policy will be greatly weakened. With the fear of aggression pushed somewhat into the background, it will be harder to make a case for import duties on the grounds of military necessity. Likewise, with the fear of business depression and unemployment somewhat allayed, increased imports will lose some of their present dangers, both real and imagined. Viewed in this setting, the proposal for a multilateral agreement on commercial policy seems not unrealistic.

## VII

The success of a multilateral agreement on commercial policy of the type which I have proposed would depend upon the active and loyal participation of the United States. The same rule holds true for agreements in the field of monetary stabilization and capital investment. Not in a spirit of boasting, but with a sober sense of the great responsibility that is inseparable from great power, we ought to recognize that the

world will look to us for leadership in all these new ventures. How shall we respond?

American commercial policy in prewar years was founded on high protection, equality of treatment, tariff autonomy, qualified by tariff bargaining, a predisposition in favor of exports, and a belief in the maintenance of free enterprise. Now, viewing the requirements and the opportunities of the future, we must reconstruct our policy. We can build securely on two prewar foundation stones—equality of treatment and freedom of enterprise—but exaggerated protectionism should have no place in our new policy. We should, instead, adopt a policy favorable to increased imports as a means of raising our standard of living and bringing our balance of payments into equilibrium. We must abandon the notion that exports make a peculiar contribution to national wealth, recognizing them merely as a means whereby we procure imports.

Ten years ago, when we adopted tariff bargaining, a bilateral process, we took a first step away from a strictly autonomous tariff policy. That step has prepared us for the second step proposed here, participation in a multilateral agreement. But in taking that step we should not scrap the Trade Agreements Program. For any multilateral agreement broad enough to be acceptable to many states with varied tariff structures and differing economic conditions will leave untouched numerous trade obstructions which could be dealt with by negotiations between pairs of countries.

In Article VII of the Lend-Lease Agreements we exchanged mutual pledges with the United Kingdom, Russia, China, and twelve other countries that we would take agreed action to eliminate discrimination in international trade and reduce tariffs and other trade barriers. Thus we have given our approval, in general, to measures designed to expand international trade. The multilateral agreement which I have proposed is designed to transfer this phase of economic co-operation out of the realm of general discussion into that of specific action. It is designed to provide the means of putting into effect the promises which we have made to our allies, and they to us, in the Lend-Lease Agreements.

Postwar co-operation, both economic and political, with other nations, and particularly with our allies, is now accepted as desirable by the bulk of the American people. But the rub will come when they are asked to transfer general principles into specific action. The acceptance on our part of an obligation to reduce tariffs as a part of a multilateral agreement will mark a real departure from tradition. It will be immediately opposed by strongly entrenched, well-organized vested interests, whose influence in Congress can be overcome only by the power of well-informed public opinion which will insist that special interests be subordinated to an overriding national interest.

## DISCUSSION

ARTHUR R. UPGREN: The three papers that have been read reveal from different points of view that the problem ahead is the restoration of reasonably free economies. In my own view we are struggling how to do this for ourselves and our friends (the United Nations) and we should give equal thought as to how we may best assist in doing it in the postwar period for our enemies (Germany, Italy, and Japan). Perhaps we shall have to exempt some of our friends from the process (Russia), but the strong reasons we have heard today for the case of the free economy may perhaps induce us to insist upon certain minimum requirements in the postwar period for those we are now supporting and opposing in war. That this view is appropriate for the former is evidenced by Article VII of the Master Lend-Lease Agreement dated February 23, 1942, wherein in return for lend-lease aid the United Nations have agreed that no discriminations shall be placed upon international commerce to be conducted after the war. In fact, Professor Viner has given this argument in showing some of the difficulties in maintaining peace that may face a world organization if we cannot solve the problem of restoring a greater measure of freedom in a world of restrictions and controls operated that are operated by government.

To restore freer economies may require breaking international cartels, but are we prepared to put provisions compelling such action into the peace terms? To be more specific I would like to state four answers to the question, "What kinds of conclusions—conclusion-drawing is always hazardous, and more so when based upon papers of others—can we draw from what we have heard?"

1. There appears to be an immense need among the United Nations for restoration of reasonably free economies. But is there conviction that free economies, if restored by laying down in the peace settlement requirements for their restoration, will bring prosperity or are the principles for such restoration to be hedged about to such an extent, at home and abroad, that we shall enlarge upon immediate prewar restrictions and controls imposed by government rather than subtract from them?

2. In the interests of world peace there is an even greater need for restoring greater economic freedom to enemy countries. We sometimes think unilateral tariff reduction on our part desirable, but do we substantially agree that such unilateral action imposed upon them is equally desirable for Germany and Italy? Two of the papers have demonstrated that government control of the economy, or of special phases of it such as tolerance in formation of international cartels, increases the odds on war. But are we prepared to specify one by one the controls and the cartel arrangements that we will insist be abolished in the peace settlement?

3. There is danger that controls may be increased. If we do not take care we seem to be hearing so much of quotas, commodity agreements, and exploratory inquiries into control devices that one may be permitted here at least to wonder if our course is to be setting up such a degree of control on our part that it will tend to become more co-ordinate with much that Messrs.

Viner and Edwards have shown to be so objectionable in more fully governmentally controlled economies.

4. According to Dr. Bidwell the agency for managing the restoration of reasonably freer trade in the postwar period must do something about (a) lowering tariffs, (b) removing quotas, (c) removing other trade restrictions, (d) establishing nondiscriminatory policies in trade, and (e) removing export subsidy arrangements. But are we prepared to specify such changes in the economic terms of the peace settlements?

Therefore, I would like to suggest that sooner or later, and more likely sooner, we shall have to make up our minds about these matters. I would further like to suggest to clarify the issue that we might lay down provisions to achieve these five objectives as clearly as possible. We also need discussion of more precise methodology. I doubt that we can move toward Dr. Bidwell's objectives without further intervention. Can we plan to use intervention, always distasteful, to reach an international trade position which most of us want? We can then chart our course with perhaps the single reservation that prearranged plebiscites in the affected countries be held at stated future time intervals to establish whether or not such planned intervention shall be abiding.

For example, export subsidies might be abolished and a plebiscite held in five years to determine whether or not such arrangement should be permanent. To illustrate the procedure, I would suggest that our thinking might run along lines that we would completely abolish quotas and other trade restrictions and hold a plebiscite in ten years to confirm or disavow such removal of restrictions. Again tariffs might be lowered by some appropriate formula (Professor Viner elsewhere has suggested what would seem to be a very desirable formula[1]) and a plebiscite held on this question in fifteen years. Finally, no plebiscite is suggested with respect to the adoption of a universal policy of nondiscrimination for the reason that in Article VII of the Master Lend-Lease Agreement the United States specified the adoption of such a policy as about the only consideration that has been specified—over and above what was contained in the original act—for Lend-Lease aid. (Adverse action in such plebiscite might be arranged to call for an *ad hoc* conference on agreements to implement the changed policies such action would imply.)

The question I am trying to raise is whether or not sufficient confidence actually does exist in the measures, suggested by Dr. Bidwell, designed to restore greater economic freedom, and therefore promote world peace as Messrs. Viner and Edwards have shown would be the case, so that we would be willing unequivocally to adopt them and be satisfied to rest for the ultimate verdict upon the results they would secure. If such results are what we now believe they would be they should induce the confirmatory votes after time sufficient to secure such results had elapsed. In any event the suggestion made poses an alternative to a variety of schemes that may be adopted which will no more generally achieve the objectives we seek than they were achieved, for example, by the use of quotas by the United States in a period in which it was embarked upon "freeing trade."

[1] *Objectives of Postwar International Economic Reconstruction* (New Wilmington, Pa.: Economic and Business Foundation).

# REGIONAL PROBLEMS

## POSTWAR POLITICAL ECONOMY OF THE FAR EAST AND THE PACIFIC

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The title of this paper is not satisfactory. It is doubtful whether one can accurately speak of a "Far Eastern economy," still less of a "Pacific economy." While the great Asiatic civilizations of China and India still retain many distinctive characteristics in their economic organization, the all-important fact is that they are being drawn more and more irresistibly into the orbit of world economy. This has long been true of other important parts of the Far East such as Japan, Manchuria, the Netherlands Indies, Malaya and, of course, Australia and New Zealand (if one may stretch the term Fart East to include them). Because of this growing interrelationship between the economies of the Far East and the West and partly because there are still too many uncertainties in the postwar economic position of Asia, I prefer not to assume the role of prophet but to concentrate attention on a more manageable and less speculative part of the whole subject. I propose, therefore, to deal mainly with the economic consequences of the war on the Far Eastern countries and with some of the economic readjustments likely to be needed after the peace. In this connection we should note that the distinction between the economic problems of war and those of peace may prove quite difficult to draw in the Far East, more particularly if the struggle against Japan is long drawn out and if the process of reconquest proceeds area by area instead of coming suddenly as a result of a general surrender by the enemy.

In this brief paper one must necessarily paint the picture in bold strokes without much detail and I therefore select only some of the larger typical economic dislocations caused by the war and some of the more pressing readjustments that will have to be faced. Moreover, I limit myself to only the more important regional or national illustrations of these problems and do not attempt to discuss the situation in each of the Pacific countries.

It is convenient to begin with some of the larger structural (one might almost say "geologic") economic changes induced by the war since it is those changes that will create the most difficult problems of adaptation once the special stimulus of war needs has been removed. Among these structural changes, both internal and international, the most important are as follows: (1) changes in the quantum and geographical distribution of industrial capacity and output; (2) disloca-

tions of the pattern of agricultural and raw material production; (3) dislocation and redirection of trade; (4) changes in labor supply, population, and migration movements; (5) disorganization of public finances, foreign investment, currencies, and exchange rates. It is worth emphasizing that all these problems and the readjustments which they imply will be greatly affected, if not dominated, by certain noneconomic factors such as considerations of security, nationalist aspirations, and the effectiveness of the political co-operation among the great nations of the world, either in a global collective organization or in some more limited nuclear alliance. These latter considerations are outside the scope of our discussion here but they must always be kept in mind if economic analysis is to have any reality.

1. *Changes in Quantum and Geographical Distribution of Industry.* Such wartime changes have been specially notable in the case of the heavy industries of India and Australia, where wartime demand has, in three or four years, created relatively advanced and specialized types of industry which under peacetime conditions might have taken many decades to develop. There has not only been an expansion in the output of iron, steel, and other metals but also great development of secondary metal products such as steel plates and structural steel along with a considerable growth of actual machine building and production of other metal manufactures. Equally important has been the development of new technical skills and factory organization, both of which may be applied to other types of production during the postwar period when the demand for tanks, trucks, landing craft, military planes, and other war equipment has disappeared.

Similar changes on a less spectacular scale have taken place in Northeast Asia, particularly in Manchuria, Korea, and North China. Here under Japanese auspices there has been considerable expansion of the iron and steel and heavy chemical industries and an accompanying development of power plants. It is, of course, difficult to appraise the exact postwar significance of these enterprises, as so much will depend upon the amount of destruction which is wrought either by the United Nations or by the retreating Japanese. It does seem likely, however, that there will remain a considerable portion of heavy industrial plants which can either be taken over intact or fairly quickly repaired by the new administration in those areas. This is true also of Formosa, though to a much smaller extent as the process of destruction there has already begun and will clearly continue. The long-term significance of these expansions of Japanese heavy industries on to the continent is that they will provide countries like China and the new Korea with an important groundwork of industrial plant and with a nucleus of skilled industrial labor. In the case of China, it is worth noting that the possession of

Manchuria will be far more important than any of the ambitious but thus far somewhat nebulous plans for large new industrialization projects in central and western China. The present industrial output of Manchuria is many times greater than anything that could be expected within the first five or six years from new heavy industry developments in other parts of China. One of the great uncertainties is how far the efficiency of the present heavy industries in Manchuria and Korea can be maintained without the present Japanese skilled workers and foremen or managerial personnel and how far the Chinese and Koreans, even with technical assistance from abroad, will be able to replace the Japanese as they will undoubtedly want to. This shortage of trained personnel, not merely technicians and senior executives but even artisans and minor administrators, is one of the greatest single obstacles facing these countries in the postwar period. It is equally serious in the political and educational fields; for instance, in the provision of capable local government officials and teachers for technical or vocational schools.

In the case of Australia and India, the postwar difficulties will be somewhat different in character and will probably be linked closely with the problem of finding export markets for some of the products of heavy industry. This will be particularly true of Australia with its limited home market and its high production costs. It would thus not be surprising if serious competition arises, even within the British Empire trading system, between India and Australia, even though it is clear that under a proper program of Indian development schemes, India's home market should be able to absorb a great part of her own iron and steel production. In mentioning this danger of competition, I do not overlook the remarkable efficiency of Australian heavy industry operating at its present high level of output; but even making allowance for this, it is difficult to see how, once the war demand has disappeared, Australia will be able to maintain its present heavy industrial production without very costly protectionist measures which in themselves will seriously hamper her effort to expand exports of primary products. The full force of the postwar competition from such countries as India may not be felt immediately, as there will be a period in which the mere replacement of worn-out plant, machinery, rolling stock, and other capital goods will absorb much of the increased iron and steel production, more particularly if owing to European reconstruction it is not possible to obtain large amounts of capital goods from Great Britain. One would also hope that Indian heavy industry and possibly Australian industry, too, would play an important role in the early stages of rehabilitation and reconstruction in Southeast Asia and perhaps parts of south China.

The above-mentioned development of new industrialized areas in the Pacific is a momentous fact. Nevertheless it is important to keep a proper sense of perspective and to remember, for instance, that the heavy industrial output of India or Australia or postwar China will be far less than that of prewar Japan proper. It is even possible that the combined heavy industrial capacity of Australia, India, and China will not exceed that of postwar Japan proper, provided, of course, that much of Japan's industry is not bombed out of existence or dismantled as part of the peace terms.

The whole difficult question of Japan's industrial future would take too long to discuss here. I can only express my own view that it would be a mistaken policy to carry a policy of reprisal to the point of trying to wipe out Japan as a major industrial nation. Aside from what is necessary for purposes of disarmament, e.g., by destruction of certain arsenals and dockyards and control of imports of key raw materials, I believe it will be found wise to let Japan retain or rebuild a good part of her heavy industry, though obviously some sections of it may be too costly to operate under peacetime conditions. Paradoxically it may even be in the interests of postwar China to have a Japanese heavy industry which can supply some of the capital goods needed for Chinese reconstruction until China's own heavy industries have greatly expanded. Furthermore, if Japan is going to make a satisfactory adjustment to the loss of such important territories as Korea and Manchuria, it would seem desirable that she should not have to depend solely on light industry, the products of which will more and more come into competition with those of other low-cost areas like China and India.

There is one other area in which we need to keep a sense of proportion. Much is being heard of the long-term significance of the migration of Chinese industry to the western provinces. No one would deny the wartime economic and psychological importance of the heroic achievements of the Chinese engineers in rebuilding factories and opening up new plants under incredible difficulties in Szechwan and Yunnan and Kansu. In relative terms, however, one must remember that the total output of these enterprises has always been pathetically small even in relation to the slight industrial production of prewar China and that their output is now tending to decline, owing to extreme inflation and the breakdown of internal transport. Undoubtedly the Chinese will be determined for defense reasons to retain and expand some of these industrial enterprises in the Far West, but I personally doubt whether these will ever be as important as some Western and Chinese writers have indicated. For many years Manchuria will probably be far more important as an industrial base for China; and looking further ahead, it would seem that the area around Hankow would become industrially

far more significant than any area in Yunnan or Szechwan where transport is difficult and consumer markets are small and distant. Looking still further into the future, one might expect the growth of a third big industrial area in north China because of its large deposits of coal and iron and abundant labor supply, much of which is not fully occupied throughout the year.

In all discussions of growth of heavy industry in the Far East, one needs to keep in mind the overwhelming importance for much of the postwar decade in that part of the world, of light industry and of the tremendous pent-up demand that will exist for low-price consumers goods. The desperate shortage of such goods today in areas like Free China, Southeast Asia, and even India is one of the outstanding problems to be grappled with. Clearly in such vast populations of pathetically low purchasing power, the great objective must be to see that this vast desire for consumers goods is made into an effective demand; i.e., by seeing that the consumers really have the necessary purchasing power. In the last resort, that can only be accomplished by increasing the productivity of both the agricultural and the industrial workers and by facilitating the exports of goods needed to pay for imported capital equipment or essential foods.

2. *Changes in the Pattern of Agricultural Production.* Despite wartime expansion of industrial production, the greater part of the Far East still depends mainly for its livelihood on agriculture—and an agriculture which is increasingly commercialized and subject to the fluctuations of both domestic and world prices. It is thus important to note that the war has produced many important shifts and dislocations in the former pattern of agricultural production. We usually think of rubber production in this connection, but other commercial crops have also been drastically affected; e.g., jute in India, cotton in north China, soy beans in Manchuria, sugar in the Philippines and the Netherlands Indies, and even rice in the great exporting countries of Burma, Thailand, and Cochin China. The cutting off of transport and overseas markets for these products has necessitated considerable shifts in production, often in the direction of more self-contained subsistence production by the substitution of food crops for industrial raw materials. The process has been intensified by the efforts of the Japanese in the occupied areas to cope with the problem of how to feed populations formerly dependent (as in Malaya and the Netherlands Indies) on a highly developed export trade. There have also been important domestic changes within such countries as India and Free China as a result of efforts to increase domestic food production to compensate for the loss of imports from areas now cut off by the war. The seriousness of this problem has been tragically demonstrated in the famine which has afflicted

Bengal and many other parts of eastern India and in the recurring famine in parts of Free China, especially Honan and northern Kwangtung Provinces.

For much of the Far East, the immediate postwar problem will continue to be the mere prevention of famine and the revival of food production in devastated areas. This may well involve imports of food from other areas for a considerable period; for instance, wheat and flour from Australia, Canada, and the United States. In the plantation areas, however, there will be different problems arising from the wartime development of synthetic or substitute products in Europe and America. This is particularly true of rubber, and I cannot venture to predict what fraction of the prewar rubber production of Southeast Asia will be restored. It seems probable, however, despite the remarkable developments in synthetic rubber production, there will be a considerable demand for natural rubber to be used largely in combination with synthetic. The problem of relative prices and trade policies will obviously be important here and this in turn will be linked up with the whole problem of currency policy and particularly the level at which such exporting countries as the Netherlands Indies decide to stabilize their exchange rate.

It is worth noting that Japan, too, will have a serious agricultural problem, particularly if the separation of Korea and Formosa shuts off her former imports of food from those areas, as it well may for a period. In time it should be possible for Japan to find alternative sources of supply from Southeast Asia, which in prewar years was able to produce rice more cheaply than either Japan proper or her dependencies, though it was not of the type which the Japanese considered very palatable. It is less likely that Japan will be in need of large wheat or flour imports, except perhaps for a short time for relief purposes, as much of her prewar wheat imports were for processing and re-export to the continent.

3. *Trade Dislocations and Readjustments.* For all our customary beliefs about self-subsistent Asiatic production, the whole area was surprisingly dependent for its welfare on trade, both intraregional and international. That trade has been both reduced in volume and distorted as to direction and composition as a consequence of Japan's co-prosperity policies and her growing shortage of shipping. The earliest possible revival of trade will be necessary, not only for the ultimate prosperity, but even for the immediate economic survival of some areas. This may well be true of Japan herself because it is hard to see how some 75 million people limited to the main Japanese islands will be able to make any tolerable economic readjustment after the war unless they can fairly quickly secure essential imports of foodstuffs and such

raw materials as cotton, wool, oil, etc. The converse of this is that Japan will have to have some opportunities for exporting manufactured goods in order to pay for those imports. The whole question of what are legitimate opportunities for Japan to have access to as markets is highly debatable and closely tied up with the actual terms of the peace. Here I would only emphasize the fact that we ought to be prepared to see a defeated and presumably "reformed" Japan play a considerable role in supplying the people of China, Southeast Asia, and possibly India with many light manufactures including textiles. It would be a tragic and misguided policy for the Western nations to attempt to reserve for themselves quasi-monopolistic privileges in the markets of the Far East and to exclude what will probably be low-priced Japanese goods from markets where the main desire is precisely for such goods. Considering Britain's own difficult postwar position and existing British sentiment in favor of bilateral or bloc trade, one cannot say that the prospects of offering relatively liberal trade opportunities to Japan are very favorable. One can only urge that more farsighted views will prevail.

The Japanese case is only one special instance of the urgent need for the revival of triangular or multilateral trade. Japan's postwar economic position may well be hopeless if her trade relations have to be adjusted on the basis of a series of bilateral agreements. The same thing is true of the exporting countries of Southeast Asia whose prosperity depended upon triangular trade adjustments among such countries as the United States, Great Britain, Japan, and Australia. Admittedly, there may be limited opportunities for smaller bilateral or intraregional trade. If, unfortunately, the world is destined to go into a period of bloc trading, the position of the Far Eastern countries will be none too happy in view of their inferior bargaining position vis-à-vis Europe and North America.

The restoration of trade throughout the Far East will be hampered by other special obstacles. For Japan the loss of merchant shipping will be peculiarly serious, especially if China should insist, as has been sometimes rumored, on taking over part of the Japanese merchant fleet for her own use, in order to diminish her earlier dependence on foreign shipping. Presumably for a period much of the Far Eastern trade will be carried in British and American ships. One can well envisage occasion for acute competition and national rivalry in that fact alone.

More serious for the whole area will be the difficulty of quickly restoring the delicate but vital network of credit, good will, established agencies, retail outlets—in short, all the components of that elusive factor of production called "organization." The Japanese will have forcibly brought about far-reaching changes in their occupied areas and

it will be difficult—in some cases perhaps undesirable—to restore the 1941 or 1939 patterns of distribution. In this connection the Chinese merchants of Southeast Asia may play a crucial role. They have long been a vital link in the internal and intraregional trade of the area and will undoubtedly try to re-establish themselves, sometimes perhaps against the wishes of local nationalists or rival Western interests. The pressure from such Western groups may be great, especially from countries like Britain and Holland which will be striving to regain their export trade. In the case of Britain the position will be further complicated by the existence of the large sterling balances which other countries such as India and Australia will hold in London. The manner in which these balances will be used is still uncertain and will no doubt depend partly on some general international agreement on currencies. One may note, however, that their existence, though in one sense symbolizing the weakness of Britain's economic position, may also give Britain a powerful bargaining weapon. One already finds a growing anxiety among Indian businessmen over such a possibility; for instance, that India will be forced to use her sterling balances in prescribed markets and for prescribed categories of goods, probably within the sterling bloc. India's position is unusual since much of her sterling balance is the direct result, not of Indian exports to England, but of an ingenious (and highly inflationary) method of paying for British and Allied war purchases in India by issuing sterling securities to India's credit in London and then printing rupee notes (with the sterling securities as backing) in order to pay for Allied expenditures in India. This process has on the one hand helped to wipe out most of India's external public debt, but on the other has certainly aggravated the twin evils of inflation and hoarding in India, thus contributing appreciably to the recent famine and continuing food crisis. Whether one calls the process an example of "British generosity" or a method of squeezing India into paying an undue share of the real costs of war depends on one's political sympathies and how one equates present sacrifices (e.g., deaths from famine) against future benefits (e.g., imports of British capital goods)! A proper judgment will only be possible when we know how freely in fact India is allowed to exercise her own choice in the use of the sterling balances after the war and how promptly she is allowed to purchase the kind of capital equipment her industrialists have been clamoring for.

4. *Changes in Labor Supply, Population, and Migration Movements.* The available evidence on wartime changes in this sphere is incomplete and not too reliable. The immediate postwar consequences of such changes may not be very apparent but of their long-term significance there can be little doubt. We have no accurate knowledge of the size and

distribution of the vast internal displacement of population within China or of how many of the displaced people will return to their former districts. We only know that the problem is vast and that as yet the machinery for dealing with it is very inadequate. Almost as difficult will be the business of repatriating the million or more Japanese nationals now scattered through eastern and southeastern Asia. Thorny questions also lie ahead in deciding whether, or under what safeguards, Chinese and Indian migration to Southeast Asia, especially Malaya and Burma, will be resumed.

For China and Japan the demobilization of armies will present peculiar difficulties and possibly serious dangers to political stability unless careful plans are made to employ demobilized men, for example, on public works or reconstruction projects. Considering the chronic shortage in China of skilled workers and foremen, one can only hope that before large-scale demobilization begins, some system of rudimentary vocational training will be introduced into the Chinese armies, thus somewhat mitigating the enormous and wasteful burden which these ill-equipped and often inactive troops impose upon China's strained economy. How far it will be possible or desirable to adopt the sometimes-debated scheme of drafting Japanese civilians or soldiers for reconstruction work in the devastated areas is hard to guess. I suspect it will not prove to be very practicable or welcome on any large scale or for any long period, though it might be used in special circumstances where large numbers of Japanese nationals were interned and awaiting repatriation.

In some regions such as Manchuria and parts of China's northwest one would hope that demobilization can be linked with schemes for colonization or resettlement. I do not suggest that such schemes are likely to be any real solution for the much vaster evil of population pressure in China. That problem will call for much more fundamental measures, and indeed one of the great dangers facing China if she embarks upon a big program of public works and industrialization is that the potential benefits (in terms of improved levels of living) may be submerged in the "torrent of babies" before the slower-working forces of education, social change, and new consumption habits operate, as they have alsewhere, to retard the age of marriage and diminish the size of families. Until that time comes the great problem will be to expand per capita productivity in industry and agriculture and, as a friend of mine has said of Puerto Rico, raise the fertility of the soil to that of the women. It is a problem which arises also in India and Java, and there, too, resettlement schemes (e.g., in Sumatra) may be useful temporary palliatives. Yet settlement, whether by immigration from

overseas as in Australia or by "inner colonization" as in the Netherlands Indies or Japan, has often been a most expensive form of public work and a dismal illustration of Smith's dictum that "of all baggage man is the most difficult to be transported." If settlement schemes in the Far East are to be more effective or to avoid the gross abuses and exploitation which attended the vast influx of Chinese into Manchuria, there will be pressing need of careful planning and financing, probably calling for special international machinery.

Living standards and real incomes were so appallingly low in most of the Far East even before the present war had forced them down to even lower levels, that the alleged menace of such "unfair" competition will probably be invoked to justify protectionist measures in other countries. Such a reaction may well be disastrous for both East and West. The danger only emphasizes the need for vigorous and far-sighted action to make an early start on the enforcement of better labor standards, at least in industrial enterprises, in the great Asiatic nations. Admittedly there will be evasion of such laws because the standards will be out of line with those prevailing in agriculture and the handicraft trades. Yet without such efforts it will be futile to expect anything but gross exploitation of labor as large-scale industrialization spreads in the Far East.

5. *Disorganization of Public Finances, Foreign Investment, Currencies, and Exchange.* I will not pretend to give an adequate discussion of these complex issues. They are all closely linked with similar problems in other parts of the world and their effective solution must involve international action on a global scale. Unbalanced budgets and currency are seen in their most extreme form in Free China today, where wholesale prices (actual, not official) are perhaps now 180 to 200 times their 1937 level. The problem of deciding what is a "reasonable" (i.e., politically expedient) exchange rate for the Chinese dollar has been difficult enough even in wartime and has begun to generate no little friction between the Chinese and the Western authorities most concerned. It is almost frightening to imagine what the "natural" rate of exchange (under noncontrolled trade) will be after perhaps two more years of accelerated inflation and blockade. It would seem almost inevitable that China will have to undergo some drastic devaluation or revaluation after the war before she can begin on a real process of financial rehabilitation. The social consequences of such a devaluation on the distribution of wealth among various groups in China may well be profound, though probably not as revolutionary as in the Germany of 1923. One hopes that the eventual postwar rate of exchange will be such as to permit China a reasonable volume of exports and also that,

under suitable safeguards, financial aid for the purpose of Chinese currency stabilization may be forthcoming from the United States and other members of the United Nations.

This problem is by no means limited to China. In different degrees Japan and even India (whose currency is linked to sterling) will feel the pressure for devaluation if they are to bring their internal price levels into line with external prices. Their national interests in this matter (e.g., in the promotion of exports through a favorable exchange rate) will often run counter to those of certain Western nations. Here again the need for early international action to forestall friction would seem to be clear, for unless some agreement on currency stabilization can be reached, the chances of starting the much-needed flow of foreign capital to the Far East for reconstruction and new industrial development will be very poor.

Apart from assurances of currency stability and, even more (in countries like China) of political stability, the great task will be to find ways of cajoling the great lending nations, especially the United States, into accepting eventual payment for their foreign investments in either goods or services; that is, unless some system of perpetual and never-to-be-settled Lend-Lease is to be continued in some utopian policy of disposing of "surplus" production and maintaining maximum employment in the lending country.

As far as China is concerned, the need for investments is immense, but Americans should perhaps not assume too readily that the United States will be the sole supplier of capital goods to China. It is not fantastic to imagine that China, and possibly India, may later wish to obtain equipment from other and cheaper sources, including perhaps Japan and western Europe. In the meantime the Chinese Government has recently made an obvious bid to attract foreign private capital by announcing more favorable (though still somewhat vague) terms for the participation of foreign capital in Chinese enterprises. In the "mixed economy" which will probably characterize postwar China, there will clearly be need for both public loans and private direct investment from Western sources. Many Chinese are apparently expecting that China, because of the unduly heavy burdens which she has had to bear in the long struggle against Japan, will have a special claim to favorable treatment in the matter of foreign loans. They are not disposed to accept any terms offered, as was shown in their refusal to accept the conditions which the British Government felt obliged to attach to the 50 million pound credit project in 1942. One may hazard the guess that the recent Chinese decision to take 200 million dollars of the parallel U.S. loan (of 500 millions) in the form of gold indicated a desire to have part of those funds available in a form which would be less subject

to the uncertainties of American politics than would be an unused credit in Washington.

Space does not permit a discussion of the various large-scale development schemes (e.g., a kind of Yangtse Valley Authority) which have occasionally been advocated; still less of wider projects of intraregional development in Southeast Asia. All one can say is that regional cooperation, mostly of an advisory or technical nature, may well prove useful, but that it is unlikely to be very important unless it forms part of an even wider program under some world development corporation or investment bank.

From what has been said it should be evident that the postwar economic readjustments of the Far East are not basically different in kind from those of Europe. Even the differences in degree are not as great as might be imagined, especially if one thinks of the poorer European regions like Spain, Poland, or some of the Balkan countries. What is significant is the enormous mass of humanity crowded into the Far East and the fact that most of this mass is so desperately close to want even in the best of times. In the telling phrase of R. H. Tawney, it is like a man standing up to his neck in water, where even a ripple can drown him. The truth of that statement has recently been tragically proved in Bengal where faulty planning and financial policy so quickly brought disaster to tens of thousands. In such areas where the slightest mistake in judgment or laxness in execution of policy may mean death for whole districts, the responsibility on the shoulders of those charged with the tasks of rehabilitation and reconstruction after the war is indeed great. So, too, the moral obligation upon the Western world towards this poverty-stricken half of humanity which, with so little reserve power, has had to assume so heavy a share of the war's burdens is something that Westerners will do well to remember if the seeds of the next world war are not to be sown in the coming peace.

## DISCUSSION

George Wythe: Dr. Munro's[1] wide experience and known competence as an historian, diplomat, financial negotiator, and administrator give him unusual qualifications in discussing this subject. I am thoroughly in accord with his view that we do not want Pan-American isolation and that we must work out inter-American economic and political relations in the framework of a world-wide nexus. I also agree that we cannot take the improved inter-American relations for granted, but must follow an active policy of collaboration.

It is to be expected that after the war the foreign trade of Latin America will revert to something like the prewar pattern, but naturally with considerable decline, at least in the early postwar years, of the trade with central Europe and Japan, and perhaps some increase in the trade within the Western Hemisphere; that is, with the United States, Canada, and among the various Latin-American countries. Personally, I think that it would not be desirable for the United States to attempt to monopolize the Latin-American trade, even if we could; in fact, I doubt if our over-all share should be much larger than it was in 1938, when it amounted to about one-third of the total Latin-American foreign trade. Dependence upon the United States both as a market and as a source of supply during the war is, of course, abnormal, as it was during the first World War. But during times of peace it is to our advantage, as well as to that of the Latin Americans, that trade should be on a world-wide basis to obtain the optimum benefits of regional specialization in all countries.

At the same time, it must be recognized that there are certain forces that may tend to increase our trade and other economic relationships with Latin America.

For one thing, Europe has been tending toward greater self-sufficiency in certain products previously obtained from Latin America, such as certain foodstuffs and nitrates; and the colonial powers before the war were shifting their purchases of vegetable oils, coffee, bananas, and the like, to their dependencies. In this connection, it will be interesting to observe the effects of the further development of Africa's resources upon the foreign trade of Latin America. Already Africa has replaced Latin America as the chief supplier of gold and cacao, and one might draw up a long list of items in which Africa and South America are competitive. Should the United States adopt policies designed to encourage the production in Latin America of certain strategic commodities on a larger scale than before the war with a view to insuring reserve supplies within this hemisphere in the case of war, such action would naturally increase our imports from Latin America and doubtless our exports as well. Furthermore, the improvement of inter-American transportation and communication facilities and the growth of tourism and cultural interchanges within the hemisphere will naturally tend to bring about closer economic relationships.

Naturally some changes in the composition of inter-American trade must be

[1] Dr. Dana G. Munro's paper, "Postwar Problems in Our Latin-American Relations," will be published in the June number of the *American Political Science Review*.

anticipated. The statement that Latin-American foreign trade consists entirely of an exchange of native raw materials for the manufactured products of other nations is somewhat out of date. A large part of Latin-American exports consists of semimanufactures, and the export of finished manufactures, which is now only a trickle, may become greater in a few lines. Likewise, while Latin-American imports consist of manufactured goods for the most part, foodstuffs, raw materials and semimanufactures are also important. It may well be, as Dr. Munro suggests, that a period of high prices for Latin-American agricultural staples might result in another cycle of overspecialization and overproduction, with the consequent neglect of the policies of diversification and industrialization that have received so much attention during the last decade.

In this connection, I feel that international commodity agreements covering the marketing of the great staple commodities, such as coffee, sugar, and wheat, might serve a useful purpose. To be sure, subsidies and state trading should be avoided, and the interest of the consumer must be amply protected. But commodity agreements that give proper representation to consuming interests might be used to prevent a cycle of overproduction and collapse such as occurred in the case of Cuban sugar, and might also be made the instrument of eliminating objectionable trade practices and leveling out excessive fluctuations in prices. It is possible that such agreements might be extended to advantage to include such articles as cinchona, from which quinine is made, in order to make this important medicinal available at lower prices to millions that cannot now afford to buy it and thus provide the basis for an international health campaign to reduce the scourge of malaria.

As regards the supply of capital to develop Latin-American resources, I agree with Dr. Munro that it would be wise to avoid excessive government-to-government loans, but I believe that the experience of the Export-Import Bank of Washington has been reassuring in this respect. The latest published report of the Bank shows that the total of outstanding loans at the end of November, 1943, was only 105 million dollars, and that more than half of the loans authorized have been extended to manufacturers and exporters of the United States to assist them in the sale of goods. The net earnings of the Bank have been over 30 millions. As regards private foreign investment, Latin America will continue to need foreign capital for some of its larger undertakings, but it would be a mistake to underestimate the extent of the local capital resources in some of the larger countries. Most of the manufacturing development has been carried out by local capital, and several countries have made it clear that they intend to insist that control of public utilities, certain natural resources, and key industrial plants shall remain in national hands. Some of the countries have been fed too rich a diet of foreign capital in the past and have not yet succeeded in digesting it. In the immediate future these countries will need assistance in the way of technique and special skills rather than in money.

I feel that Dr. Munro rather underestimates the significance of the industrial development that has occurred, as well as the possibilities for further expansion along certain lines. At the same time, he is right in pointing out the danger of pushing developments too far and too fast without proper relation

to the size of the national market. Industrialization should be part of a broader program which will include improvement of agricultural methods, sanitation and health programs, and a broader distribution of wealth. There is a great danger that unwise policies of trade, monopolistic controls, and excessive nationalism may stifle the productive forces.

As regards the immediate postwar period, it will be a miracle if we and the other American Republics can entirely escape some very rough bumps in liquidating a war of the magnitude of this one. But we should be able to profit to some extent at least from the experience after the last war. There is some danger in the fact that the Latin-American countries have accumulated very large reserves of gold and foreign exchange, which might result in an orgy of buying at high prices, with a result that when the readjustment begins there will be a wave of cancellations and trade complaints. I am certainly in favor of eliminating as many restrictions to international trade as possible, but I believe that in the long run international trade will be healthier if the controls are tapered off gradually. Furthermore, I believe there is a definite place for exchange controls of the right type, while avoiding the exchange rationing and licensing-types of controls that have been obstructive in the past. It seems to me desirable that the Latin-American countries should develop trained personnel in their central banks and government departments and that machinery should exist to prevent excesses that might lead to financial and economic chaos.

Some of the policies that the United States has adopted during the war also provide a means of cushioning the bumps during the transition period. I only have time to mention, without discussing, such things as the purchase contracts, which extend for several years and might be renewed, new purchases for the United Nations Relief and Rehabilitation Administration, the continuing institutes established by the Co-ordinator of Inter-American Affairs in the field of sanitation and transportation, the possibility of stock-piling, and the various co-operative programs being carried out both by the government and by private institutions. Furthermore, I feel that some way will be found to provide a continuing market for some of the newer exports from Latin America that are of significance in connection with our national defense policy.

Amos E. Taylor: With a view to amplification rather than criticism, my observations on Professor Munro's paper are limited to a brief discussion of the postwar economic potential of the United States and its bearing upon the postwar problems of the Latin-American countries. The degree to which most of these countries are normally able to participate in the flow of international trade is determined in large part by the demand in industrial countries for raw materials and certain basic agricultural products. The ability of the former to secure the foreign exchange essential to the purchase abroad of their own import requirements and for meeting any other obligations abroad depends therefore upon the extent to which the prosperity of the world generally can provide an adequate market for these basic materials.

Although the United States exports only 8 or 9 per cent of its total production, this fraction normally constitutes from 12 to 15 per cent of the world's

total export trade. Its imports represent from 8 to 10 per cent of the world's total import trade. It is thus obvious that, since business conditions in the United States determine the inflow of raw materials and other imports, a high level of production and national income in the United States is of tremendous importance to the economic prosperity of our neighbors to the south of us. Economic and social stability in countries dependent upon the export of two or three basic commodities for essential foreign exchange depends upon the level of international trade generally. Under favorable conditions exchange problems are relatively easy of solution and standards of living can be expected to rise or at least be sustained on a reasonably high level.

Since trade and finance move hand in hand, it is perhaps appropriate that we pay some attention to the manner in which the flow of capital for developmental purposes should be directed so as to create the least possible disturbance in the world's economy. Equity investment through the direct participation of private enterprise in foreign areas possesses the advantage of not requiring heavy transfers of earnings at a time when adverse conditions tend to place a strain on the exchanges. This method of investment for developmental purposes also provides a ready means for the participation of local capital. Even though in many areas the possibilities of local investment are distinctly limited, the encouragement of its participation promises greater stability than the absence of such incentives. A potential dictator thus tends to have the effect of his appeal neutralized whenever in times of momentary distress he takes advantage of the situation to attack the foreign "exploiter."

# INTERNATIONAL MONETARY PROBLEMS

## THE POSTWAR MONETARY PLANS

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### I

The problem of postwar currency stabilization is many sided, and I hope I shall not merely repeat today my recent papers in *Foreign Affairs*.[1] Since the Keynes and the White plans were published last April there have been many able articles about them. The next step presumably will be the production of a joint plan by the experts of our own and the British Treasury, and until that appears further analysis of the mechanical and organizational features of the plans might well be suspended. My chief interest is in the nature of the problem and the basic issues which may decide national attitudes.

I must begin by emphasizing again the difference between the transition period from war to peace and the longer run. Such problems as relief and reconstruction and the liquidation of the large wartime balances that have accumulated in England call for loans and gifts, or the extension of Lend-Lease. They indicate the need for a bank rather than an exchange stabilization fund—though I have not been able to see how such a bank can be international, except in a formal or limited sense, in a world containing only one large creditor and many debtors. It is of the essence of currency stabilization that departures from an even-balance position in the stabilization fund or clearing union should be only temporary and should set in motion forces to restore the balance. This is like the requirement of two-way gold flow under the gold standard. If the new currency plan were used to finance the abnormal requirements of the transition period it would run a grave chance of being wrecked at the outset. A chronic lopsided condition would develop; and both deficit and surplus countries would have to pursue the corrective measures called for by the plan, not by reason of anything in their by then more normal situations, but solely because of the misuse of the fund in the transition period.

I have favored for this reason postponing the new currency plan and relying for exchange stability in the early years primarily upon exchange control. There is much force, however, in the view that the only time, if ever, the nations would adopt a currency plan is under the stress of close wartime association; we had better adopt the plan now, even

[1] John H. Williams, "Currency Stabilization: The Keynes and White Plans," *Foreign Affairs,* July, 1943, and "Currency Stabilization: American and British Attitudes," *Foreign Affairs,* Jan., 1944.

though we put it only gradually into effect; and meantime we must see to it that adequate, and completely separate, provision is made for the needs of the transition period. This view would rest the case for the currency plan entirely upon its adequacy and feasibilty for longer-run monetary stabilization, and it is to that problem that I wish to address my paper.

The new plans are an attempt to modify rather than completely to supplant the gold standard. There are three ways in which modifications can be made: by creating more official exchange to settle international balances, by permitting variations of exchange rates, and by controlling exchange transactions. To the first all might agree, not because the present gold stock is inadequate, but because it is badly distributed; but once better distribution is provided for, there will be marked differences of view between those who want to modify the gold standard much and those who want to modify it less. The former will want a large stabilization fund and the latter a smaller one, and the same differences will appear as to the other methods. How to reconcile views on these three points and get a system that will provide international stability—a system that is both workable and acceptable to nations of divergent views and circumstances—is the essence of the problem.

How divergent the views are has been amply shown by the discussion since last April in this country and in Britain. American banking and press comment has been hostile to both the Keynes and the White plan, and much of it has insisted upon a straight-out restoration of the gold standard. English opinion, in all classes, has been equally insistent that there be no return to the "strait jacket of 1925-31," and seems prepared to go even to the length of bilateral trade arrangements and a general system of exchange controls, if necessary, to avoid any currency plan they fear might prove too rigid.

I greatly sympathize with the English fears of a too rigid system. They go to the heart of the question why the gold standard must be modified. I need not review the voluminous, and often acrimonious, discussions of the interwar period. Under modern conditions the gold standard has frequently not been the efficient instrument of two-sided compensatory international adjustment it was meant to be. It has been a means of spreading depressions, and sometimes booms, from one country to another. One of the great defects of gold standard theory has been its failure to take account of the business cycle. This has several aspects. The play of national price levels about the fixed exchange rate which was the essence of the classical theory takes no account of the cumulative character of price movements and their relation to fluctuations of output and employment. Quite as much as the rest of classical theory,

the gold standard took for granted full employment. But now it has become a commonplace to speak of the deflationary or inflationary effects of the gold standard, and out of such effects has arisen the desire to protect the home economy from external pressures operating through the gold standard.

The relation of capital movements to economic fluctuations is another important aspect, presenting a problem not only of panicky flights of capital but also of the spreading of booms and depressions, or of a boom in one country feeding upon deflation elsewhere, as in the case of our attraction of capital from Europe in the late twenties. Gold standard theory, moreover, has never really taken account of the modern monetary analysis in terms of income flow—the relations of investment, saving, and consumption. Though there have been analyses of the foreign trade multiplier, and how balance of payments changes affect the national income as income-increasing or -decreasing factors, this is quite a different thing from tying the analysis into a logical system of compensatory adjustments. The subject has usually been approached from the standpoint of how to protect the home economy from external contractive forces or how to maximize external expansive forces, rather than from the standpoint of how to make international currency stabilization work. Indeed, many of those engaged in the analysis have, or at any rate thought they had in the thirties, quite given up an international approach to the problem of economic stability.

Since their interwar experience, the British complaint has been that the gold standard works one-sidedly, by contraction in the deficit countries rather than expansion in the surplus countries. Apart from what I have said above, there are at least two good reasons why it can work in that way. One is the unequal importance of the balance of payments as between countries whose foreign trade and other payments are large relative to the home economy and countries for which foreign trade is less important. The other is the unequal size of countries. Gold standard theory was based on the principle of interaction between homogeneous countries of approximately equal economic size. Gold standard practice in the nineteenth century, I have always felt, operated not on this principle but on that of a common center with which the other countries were connected through trade and finance. But now that we have neither of these principles to work on, the unequal size of countries presents problems with which the gold standard cannot cope; nor do I think that the creation of an international governing body to recommend, or even to impose, corrective measures would by itself prove adequate for the task.

Both difficulties I have mentioned point to the United States as a

main reason why the gold standard cannot work as originally intended. A large export surplus, or any other change leading to substantial gold inflow, would be likely to have a far less expansive effect here than contractive effect upon the deficit countries. This unequal effect of international changes and our peculiar relation to the problem raise sobering thoughts for a country which as the chief creditor and the largest country must take, and will be expected to take, the leading responsibility for any scheme for currency stabilization. We must satisfy ourselves that the plan to be adopted has a reasonable prospect of success.

## II

I quite agree that the gold standard must be modified, and in my view all three types of modifications will be needed. But the difficult question is how far to go without undermining and defeating the process of mutual adjustments in a multilateral trading system. We need to increase the amount of official exchange balances, not only to correct the present unequal distribution of gold, but also to give more leeway for corrective action to countries which, from the nature of their situation, may be subject to a hazard of large, internally disturbing deficits in their international balance. One of the chief lessons of the interwar period was that some room for exchange-rate variation should be provided, both to permit countries to find new equilibrium rates after international relations have been profoundly changed by war and to make further adjustments as basic circumstances may require. On exchange control, international trade theorists give ground very grudgingly, and quite understandably, since it strikes at the basic principle of a free trading system and has a natural affinity with the whole apparatus of restrictive trade practices that we saw at work in the thirties. But granting that panic flights of capital would be greatly lessened, to dimensions which might be handled by other means, through restoration of political and economic security abroad, the control of business cycle disturbances arising out of capital movements may well, in my opinion, require some exchange control. Some British economists have advocated control over capital resident in England, while permitting free movement of foreign capital, which seems to me a workable and desirable compromise for England's case. The fact that a partial exchange control requires setting up the machinery for a complete control and then freeing some kinds of transactions from it by general licenses does not seem to me a formidable obstacle after all the experience in operating exchange controls that has been acquired during the war.

A priori, there is little ground for favoring one type of modification and rejecting others; which is preferable depends upon the special circumstances of the case; and of course very much depends upon the

intelligence and the intentions of the users. We must recognize that all are methods of interfering with the process of two-sided international adjustment, and of forcing the burden upon other countries. In the interwar period it was the vicious circle character of exchange depreciation that stirred up controversy and retaliation, perhaps even more than the exchange control practices, which were in large part the aftermath. A very large exchange fund, likewise, might hinder rather than help the adjustment process, by providing so much leeway as to permit a country to neglect to take corrective measures. Some of the stabilization schemes I have seen come to just about that, by providing for periodic cancellation of balances if they bother either party, and much of the discussion of foreign "investment" as the balancing agent seems just about as mechanical.

In pointing out both the necessity and the dangers of modifying the gold standard, I am not criticizing the official plans. I shall be much surprised if the final joint product does not allow considerable latitude for all three types of modification, and I do not doubt either that a genuine effort will be made to guard against misuse, both through formalized rules and the discretionary powers of the international governing body. But whether such measures will really have teeth will depend primarily upon the national attitudes; and the sharp divergence of attitude here and in England does not promise well for adoption, or for effective operation of the plan even if it were adopted. If we do not go far enough in willingness to modify the gold standard, the British seem to want to go too far. For the one-sided process of adjustment which they feel the gold standard under modern conditions has imposed on deficit countries, they seem to want to substitute a process which would place the burden solely or mainly on the surplus countries. I cannot see how else to interpret the statement often made that a surplus country need never have a larger surplus than it wants to have.[2]

I have wondered in reading some of the British comment whether what they want is to be able to isolate themselves from international pressures through an entire depression, to protect themselves from one originating abroad and have a free hand for dealing with one arising at home. Granting, as I have sought to indicate, that there are at times strong grounds for such a course, this surely cannot be called an *international* solution of the problem of stability. Carried that far it would amount to giving up the search. It would be ironical if in the name of international monetary stabilization we achieved such a result.

The problem is indeed bewildering. Perhaps it will clarify my attitude if I say at once that I cannot pretend to have a solution for it. I can do no more than indicate what are the lines, in my view, along

[2] For fuller discussion see *ibid.*, Jan., 1944, pp. 238-240.

which the solution must be sought, if the problem is soluble at all. We can recognize that the gold standard as it has worked has been a spreader of depression, but is anything more clear than that historically the methods of modifying it have worked to relieve depression at home by creating it elsewhere? I agree that the solution, at least in part, must be sought along the line of modifying the gold standard, but not by shifting entirely, or even mainly, the burden of adjustment to someone else. So far as the solution can be international, the hard core of it will always be the necessity for two-sided adjustment, painful though that will doubtless always be for both sides.

What disturbs me is the desire to run away from it. The weakest feature of the official plans is the almost complete failure to mention the need for internal adjustments. As Keynes put in his White Paper, "the plan should not wander from the international terrain." The reason for the omission is doubtless in part political. But it indicates also, I believe, a wrong twist that has developed in our thinking about international adjustment, and indeed about the whole problem of economic stability. Joan Robinson speaks of the gold standard's forcing a deficit country "to redress its balance in the most disagreeable and wasteful manner," and welcomes the new plans as providing "less painful alternative methods of redress."[3] The "alternative methods" are what I have called the ways of modifying the gold standard. They must not, in my view, go so far as to supplant it. They are not truly alternative methods of adjustment but ways of escaping from it. They should be reserved for what we must hope will be the rare occasions when international adjustment is too costly. When, for example, a great war has disrupted international relations and rendered exchange rates meaningless, it would make no sense to insist on internal adjustments to the current rate; the new equilibrium must be found by varying the exchange rate. Or in a period of large and rapid international changes, such as may occur after war and extend for perhaps a long period, we may have to recognize the need for further such adjustments. A great world-wide depression, representing a failure to preserve stability by either international or national means, would present a similar problem. But these are not cases of international adjustment in any sense that is pertinent for the operation of a long-run currency plan. They are ways of breaking off from a fundamentally bad situation and tying on again at points which offer more prospect for stable international intercourse for the future. We hope, it is true, that by using such methods, by common consent instead of competitively, we can help prevent such chaos from developing. But they carry always such dangers of spread-

[3] Joan Robinson, "The International Currency Proposals," *Economic Journal,* June-Sept., 1943, pp. 171-172.

ing disturbances more widely that they should be used as the last, and the rare, resort rather than the favored method.

As I have said, they are not truly alternative methods of adjustment. So far as disturbances in the balance of payments are concerned, a new equality of payments can be reached, or the absence of it temporarily ignored, by these various methods. These, however, are not ways of adjusting to international changes but ways of disposing of such changes by shutting them off. The short-run protection of the home economy such actions may afford has to be measured against the long-run losses in terms of productivity and international division of labor this shutting-off process entails, as well as, of course, against the short-run injury done to others and the threat of collapse of the whole system. To speak of international stabilization in a multilateral trade system as being achieved primarily by such methods becomes a contradiction in terms. Some British economists have said that rather than have a too rigid system they would prefer frankly to subordinate international trade and try bilateral trade arrangements. My suggestion is that if the system is not rigid enough that will probably be its outcome anyway.

The block that has been built up in our minds against internal price adjustments, in the development of the closed economy analysis during the interwar period, rests, as I said earlier, upon the view that such adjustments are inflationary or deflationary. I grant that they are, if left to take their own course. That the classical economists did not so recognize them was due, as I have said, to the fact that they left out the business cycle. What we need today is a means of bringing about by conscious economic policy what the classical economists intended. Whether the internal price adjustments are deflationary or not depends on how they are combined with other policies. In the Great Depression, Sweden and Australia were able to combine substantial downward adjustments of wage rates and other costs with expansionary monetary and fiscal measures, and with exchange rate adjustments designed to improve their international position and to stimulate recovery. It is noteworthy that these are progressive countries and that the measures in question had the support of a majority of organized labor. In Britain today, and in some other countries, the development of a conscious state responsibility for social welfare, the plans for improving social security, the political as well as the economic emphasis upon the maintenance of full employment by measures reasonably under national control rather than in response to international forces whose control must be shared with others, provide ample explanation why fears are felt of too rigid currency plans. But unless a reasonably stable multilateral trade system can be worked out the internal objectives will probably be jeopardized as well.

## III

I have tried to indicate the lines on which, insofar as monetary stabilization can be achieved by international means, the solution must be sought. Of course, monetary stabilization is only a part, and before passing judgment we must ask to see the other parts, of the international program, which Keynes has stated will deal with commercial policy, medium and long-term investment, and stabilizing the prices of primary products in international trade. But all these, important as they are, and assuming all to be well done, will not be enough. What will matter even more will be our success or failure in maintaining high income and employment here at home.

In the discussion of internal versus external stability about which the gold standard controversy mainly revolved in the interwar period there was something lacking. It put the emphasis on the need for sacrificing one to save the other. The element of truth in it—that we have to choose, for example, between stable exchange rates and stable internal prices—is what I have discussed in the last section, though coming to a different conclusion from those who posed the question. Internal stability at the expense of world trade, or at the expense of other countries, is not a good long-run answer. But what the question leaves out is the fact that under modern conditions, external stability must essentially depend on internal stability in the major countries and especially in the United States.

That this is so becomes readily apparent when we think in terms of the income flow analysis. The net international balance of debit or credit is a small magnitude compared with the categories of expenditure mainly responsible for fluctuations in net national income and in employment. For example, in 1919, a year in which our net export surplus was abnormally large, it amounted to 3.7 billion dollars against aggregate expenditures of 22.5 billions for consumer durable goods, inventory accumulation, equipment, and construction. A net export surplus of comparable size relative to net national income in the first year after this war would be about 7 billion dollars as against an aggregate of about 42 billions for the other items.[4] Such an export surplus, it need hardly be said, would be huge; it might easily threaten serious inflation here. It is even clearer that such a surplus, if foreign countries had to pay for it, would not be long in exerting serious deflation there. Yet, in the grand total of income-increasing or -decreasing factors even in a year of such swollen exports as 1919, it was only about one-seventh and the domestic factors were six-sevenths. It seems clear enough from such figures that external stability will depend upon stability at home.

[4] A. H. Hansen, "Wanted: Ten Million Jobs," *Atlantic Monthly*, Sept., 1943.

This does not, however, make the problem any simpler or more certain of solution. The maintenance of high production and employment at home under peacetime conditions is a problem no less complex than that of international currency stabilization. On the methods to be employed, national opinion is far from united, and government planning for the postwar period seems less advanced than on the currency problem. What disturbs me most is that I am not at all sure we shall know what to do. The economic outlook was never more uncertain. When one considers the huge accumulation of wartime savings and liquid assets and the large pent-up demands for consumer durable goods and probably also for some kinds of producer goods, compared with the scarcity of peacetime goods in the transition period, the possibility of postwar inflation seems very real. But when we think of the task of demobilizing and reabsorbing some eight million workers from the armed forces and perhaps four millions more from the war industries, and at the same time contracting the federal military budget of some 90 billion dollars a year to peacetime dimensions, the prospect of severe deflationary pressure, perhaps after the more urgent deferred demands for goods have been satisfied and the increased output of civilian goods is well under way, seems no less real.

Our prescription for dealing with such changes in a peacetime economy is mainly fiscal policy. Since the early thirties it has become the center of our thinking much as central bank policy was during the twenties. It has been the history of the development of major ideas about economic policy that there is a warming-up period and a cooling-off period. We have yet to look at fiscal policy in a proper historical perspective. Though undoubtedly a long step forward, I think it will be found to have much the same kind of limitations that characterize the monetary policy out of which it developed. It is a partial and oversimplified analysis, dealing with large aggregates of the income flow, tending to take what goes on inside these aggregates for granted as something beyond our powers of control and contenting itself with trying to compensate for the economic fluctuations that ensue. I cannot in this paper do more than state very briefly my views about fiscal policy. In the past decade or so it has gone through three fairly distinct phases, the last one being born of the war. We seem always, and the same was true earlier of central bank policy, to be a step behind, the turns in our thinking following the turns in events rather than the other way around. The most outstanding fact about the war has been the almost incredible expansion of output. We have had a new vision of our economic potentialities. The emphasis in fiscal policy has switched from what we need to do to shore up a contracting economy to what we can do to realize the full benefits of our productive power. This is a much

more wholesome and challenging emphasis. But I am not sure where it leads us in fiscal policy. The increase in output has been much referred to as the proof of what a large-scale spending program can accomplish; our mistake in the thirties, according to this view, was that our sights were much too low; we should have spent much more than we did. But this to me is a dubious proposition. In analyzing the wartime increase of output we seem to be getting the cart before the horse. What we have had has been a production program, and one increasingly totalitarian in method; the spending has been a result more than a cause of the increased production. It is true that in the earlier years of the war, before direct controls were so much developed, we did see a marked expansion of civilian consumption and production which was undoubtedly due to the development of the military program, as a kind of by-product of which perhaps we were more fearful than proud. But even that experience does not really prove much because it grew out of the certainty that production would and must be expanded further. The ordinary motivation which we speak of in connection with the effects of public expenditure on investment and consumption was even then lacking.

There is one wartime development which does not fit in at all well with our assumptions about fiscal policy. As our attention has become more centered upon the threat of inflation and the need for curtailing civilian expenditure, our power to do so by fiscal means has proved woefully deficient, and we have become concerned about the growing inflationary gap. Though fiscal policy was largely devised as a means of compensating for income leakages through saving, it seems always to assume that the new income publicly created will be spent. This is reminiscent of earlier assumptions in monetary theory, such as that banks would always use their reserves. I have been thinking much about the analogy between the excess reserves which a decade ago finally wound up the argument about what central banking could accomplish and this new problem of excess reserves, so to speak, in the pockets of the consumers. Apparently quantitative assumptions about money and about money incomes are subject to the same kind of defect. All in all, I do not feel that the war has given us a very convincing demonstration of what fiscal policy can accomplish.

Not to continue too long in my limited space, there seem to be at least two main questions for the future. One is how much monetary and fiscal policies will need to be supplemented by more direct controls. Obviously for the immediate postwar period these controls will need to be continued, but what of the longer future? Some economists are now beginning to speak of what they call partial depressions as contrasted with one like the early thirties which obviously calls perforce for a vast

amount of spending. What must we do when by fiscal policies or other means we find ourselves in a condition where expenditures are excessive in some directions or parts of the economy and deficient in others? We saw in 1936-37 and in the early phases of the war how this condition can arise at a comparatively low level of national income and employment. Must we not then use more direct controls to make the fiscal policies effective? Can high production and employment ever be attained by fiscal policies alone?[5]

I do not know the answers to these questions, but part of the answer seems to lie in the necessity for striving for greater flexibility; this is the second of my two main questions. One of the most marked characteristics of monetary and fiscal theory has been the tendency to take the price structure for granted, as something we cannot change but can compensate for. This is the same point that I was emphasizing earlier in the discussion of international currency stability. If we could have more of the price adjustment approach to the domestic problem we would be pursuing the method which seems essential also for the international problem. It is at this point that the two unite, and I cannot avoid the feeling that in taking the cost-price relationships for granted, or at least avoiding any downward pressure for fear of its deflationary effects, the closed economy analysis of the interwar period not only did international stability a great disservice but confused and impaired our approach to the problem of internal stability as well.

How much cost-price adjustment and mobility of factors can be achieved without direct controls is perhaps our largest economic question for the future. If we want to preserve our kind of economic system we will make the most serious efforts along these lines. It would seem that much could be accomplished through the study of monopoly problems and through attention to the conditions of specific industries. The construction industry is perhaps the best case in point. In fiscal policy we are apt to approach it quantitatively as part of the aggregate of investment and call on government spending to make good deficiencies. But it is notoriously a backward industry characterized by high costs, primitive methods, and monopolistic and racketeering elements. Attention to the industry itself might provide our best answer. One kind of direct control, however, will almost certainly be needed. We have reached the point apparently where such questions as wage rates and agricultural prices relative to industrial prices must be politically determined; we must have a national labor policy, agricultural policy, and so on. In this sense, we shall probably need to retain a kind of direct

[5] I think these questions are always present, even in a great depression but are then more obscured. They raise questions especially about cost and price relations and mobility of economic factors.

control in broad terms, though we shall probably be able to do away gradually, as the transition to peace is worked out, with the more specific types of control we have today.

But some other countries may go much further with direct controls than this country seems likely to do. Some English political leaders and economists are asking why if direct controls work so well in wartime they should not be retained in peace, and not merely for the transition period. The statement is becoming fairly common among them that public works and the like will not be enough. We are likely to find after the war a very mixed world, with some young countries where we were as regards public intervention before the first war; this country farther along than it was in the interwar period, though what the developments will be it would be rash to predict; England and some other countries with much more government intervention than this country though probably still trying to preserve some of the forms and as much as possible of the substance and the motivation of a private enterprise system; and Russia and some other countries definitely committed to a quite different kind of system. Of the enemy countries and occupied Europe it seems impossible to speak.

## IV

In my previous papers about the currency plans I have expressed doubts about the wisdom of adopting at once a formalized plan, with rules and procedures, votes and quotas, and an international governing body. I have doubted whether in the present divided state of national attitudes and circumstances the world was ready for such a plan, or that it would really have teeth even if it were adopted. One important point that I have not yet mentioned in this paper is that there would be left out of the plans as I last saw them some 13 or 14 billion dollars of gold and official dollar balances outside the United States, so that it is not difficult to see how a dual monetary system might develop, the countries strong in gold resources going round the plan and avoiding its corrective pressures, and only the weaker and more necessitous countries using it. The history of international co-operative organizations provides many illustrations of how nations can find both the means and the motives of defeating their purposes. But assuming the best of intentions all around, and assuming also the point with which I began this paper, that there must be a complete separation between the program for the transition period and the longer run, I would still prefer a more gradual approach to the problem.

The one I have suggested elsewhere, the so-called "key countries" approach, would begin with the currencies most essential for world trade, and particularly the dollar-sterling rate, and would provide cri-

teria as to the conditions under which other countries could be brought in under some more comprehensive scheme. One advantage such an approach has is that we might thus avoid the difficult and somewhat artificial task of having to decide when the transition period ends and the long run begins. They would merge into each other in a more gradual unfolding of the problem. But the main advantage, I think, is that until we have more knowledge of the problem, and more agreement about our knowledge, we should not embark upon an elaborate enterprise and invite perhaps a more spectacular failure. The point I have tried especially to add in this paper to what I said before is how much the international solution depends upon the domestic, and as I think about that and the many uncertainties it raises, it does not lessen my fears about premature adoption of elaborate world currency plans.

# CAN NATIONAL AND INTERNATIONAL MONETARY POLICIES BE RECONCILED?

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If it were more generally recognized that an international monetary mechanism does not simply fill in a void between national controls, if it were realized that an international standard or system necessarily means control, and furthermore that international means necessarily supernational, agreement as to the main features of the desirable postwar system would be facilitated. The war seems to have produced little if any abatement of jealousy of national prerogatives, and it is undoubtedly realistic to take this as grounds for skepticism regarding the present international currency plans. But complete realism could easily mean surrendering to monetary autarchy; any advance requires some resolution in the direction of "reform." A curious contradiction is fostered, however, by certain economists who clearly desire to rehabilitate international trade and finance, but who unwittingly throw in their weight toward economic isolation by advocating some sort of impersonal, automatic, and international machinery which, they imagine, requires no sacrifice of national sovereignty. This unintended isolationism takes the form most commonly of opposition to such schemes as Keynes's and White's because of a nostalgia for something vaguely associated with the gold standard.[1] I do not refer to criticism of the details of these plans, but rather to categoric opposition which proceeds from a sort of misconceived liberalism. The present analysis strives to offset this error; it supports the view that control inevitably extends over international monetary phenomena in any event, and that the real problem consists in securing the surrender of national sovereignty to the requisite degree; and it attempts to indicate some necessary extensions of the currency plans in their present formulation.

## I

The proponents of controlled economy quite understandably want a free hand for national monetary policies; but the experience of the thirties seems to have brought a recognition even in these quarters that independent and frequently undercutting devices such as unrestrained devaluation, bilateralism, exchange control, and discrimination, instead of assuring a free hand, tie the hands of all countries. Aside from the

[1] Cf. Winthrop W. Aldrich, *The Problem of Post-War Monetary Stabilization* (Chase National Bank, April 29, 1943); B. M. Anderson, "Postwar Stabilization of Foreign Exchange," *The Economic Bulletin* (Los Angeles, California), Vol. IV, no. 1 (May 11, 1943); E. W. Kemmerer, "The Future of the Gold Standard," *The Commercial and Financial Chronicle*, April 1, 1943.

ebbing enthusiasm for these devices, less exclusive reliance seems to be put upon the elasticity of demand for imports with high domestic incomes to guarantee a flourishing volume of international trade. It is significant that the leading proponent of economic nationalism in the twenties and early thirties now champions an international clearing union to rehabilitate internationalism in exchange payments. Despite this moderating tendency, we may expect the controlled economy school to regard the whole arsenal of direct national controls as a convenient resort on occasion, and consequently to be chary of reductions in national sovereignty.

Unregulated unilateral action, directly adverse to international equilibrium or restrictive upon the volume of productive trade and capital movements, can only be curbed by a transfer of function from national to international auspices. Similarly the inaction of an individual country, whether in refusing to adapt its exchange rate toward equilibrium or in failing to pursue domestic monetary policies compatible with complete utilization of resources abroad, can only be met by an authority over national organs. There is nothing bizarre in the proposition that, just as the sovereignty of the United States is required in order to secure a national price system and maximize the volume of interregional trade—through suppressing state tariff barriers, quotas, bilateral clearing, etc., and through forbidding or regulating autonomous state monetary measures such as exchange control, discriminating exchange rates, devaluations—so international sovereignty is required for the same purposes when we think of nations.

So far as concerns commercial policy, no one imagines that any automatic mechanism operates to curb restrictive national policies. The common welfare depends entirely upon the individual country's decision to act in the group interest (which rarely happens), upon its *ad hoc* agreement with another country to observe certain mutual norms, or upon its submission to a general rule (e.g., most-favored-nation clause), or submission to a discretionary authority (such as the proposed international commodity stabilization office). These successive steps can be viewed realistically only as progressive degrees of restriction upon national sovereignty. Can it be otherwise in monetary matters? There, also, no objective, impersonal, or automatic mechanism exists, or has existed, to curb disequilibrating national policies. If individual action or *ad hoc* agreement cannot be relied upon to restrain offensive practices—witness the consequences of the Great Depression—the only remedies are submission to general rules or to discretionary authority.

Notwithstanding authoritative opinion to the contrary, the historical gold standard constitutes not a refutation but a proof of this argument. Mr. Per Jacobsson, economist of the Bank for International Settlements, believes that:

Before 1914 it was one of the great advantages of the international gold standard that it effectively ensured voluntary discipline in the monetary policy of the various countries without it being necessary for their sovereignty to be restricted.[2]

In similar vein, Professor Graham writes:

The gold standard was spontaneously adopted by each of the cooperating countries. The resulting identity of monetary-policy, without any impairment of monetary sovereignty, in turn established the unison in price level movements essential to the preservation of the fixed exchange rate structure.[3]

I do not care to insist, though I believe, that a reduction of sovereignty is no less genuine if its origin is voluntary submission; but in all events the classical epoch of the gold standard certainly entailed loss of freedom not only to objective rules, but also to some extent to discretionary authority. The loss to rules was twofold: freedom as to the rate of exchange and, within certain limits, freedom as to domestic finance. In the first of these respects, the national sovereignty, though not surrendered to outside agency, was effectively limited by the belief that devaluation amounted to default. But sovereignty was actually voluntarily surrendered to outside-authority to the degree to which the overall management of gold was left to the London money market and the bank rate and other policies of the Bank of England.[4] And freedom as to domestic finance was limited not only by the moral obligation to contract credit with a loss of reserves in order to avoid devaluation but also by "playing the game" in expanding credit with an accretion to reserves. Furthermore it became apparent during the thirties that restrictive commercial policies could undermine the gold standard as effectively as perverse monetary policies; and the conclusion was unavoidable that national autonomy, even in commercial policy, cannot remain intact if an international monetary mechanism is to exist.

To take the place of the governance of London and the repudiated rules concerning devaluation and credit expansion, it is indeed possible to conceive of a thoroughly automatic international monetary system. But such a system would involve far more revolutionary changes in domestic monetary institutions and a more complete abdication of national power than the currency plans contemplate; and furthermore it would prove to be so ill-assorted to the character of contemporary economic systems as to be completely anomalous. In order to make an international monetary system automatic it is necessary to put it beyond the influence of national monetary policy. An absolutely general and inflexible rule against devaluation coupled with an equally rigid rule requiring the same ratio of expansion and contraction on reserves would,

[2] Quoted in the *Economist* (London), Nov. 28, 1942, pp. 655-656.
[3] Frank D. Graham, *Fundamentals of International Monetary Policy* (Princeton, 1943), p. 11.
[4] Cf. W. A. Brown, Jr., *The International Gold Standard Re-interpreted 1914-1934* (New York, 1940).

if carried out, obliterate individual national autonomy. As long, however, as independent national monetary reserve systems exist, there is no guarantee, even if the central monetary authorities desire it, that credit would expand or contract in any predictable fashion upon the basis of a given loss or gain in reserves; in other words, as long as commercial banking exists, there can be no assurance that domestic credit follow any automatic pattern. The institution of 100 per cent reserve money in all participating economies coupled with the adoption of invariable international parities would, as Hayek has argued,[5] create the strictly automatic mechanism which seems to be desired in some quarters; and, as far as I can see, this abolition of commercial and central banking is the only device for securing it.

Such a system would, indeed, offer certain advantages. By agreement of the participating countries, gold could play almost any conceivable role. If, for example, it were desired to make the volume of international currency "objectively" determined, existing stocks and newly produced gold could be converted into the currency at a fixed price. If discretionary authority were admitted to a certain extent, the authority could vary the price to expand or contract the currency to meet global changes in effective demand, output, population, liquidity preferences, etc.; and gold could even be demonetized without cataclysmic effects on money. National treasuries could carry on deficit financing to increase employment, but only by borrowing savings (from hoards). The lever of monetary expansion would be shortened though not completely removed; but the possibilities of deflation would be correspondingly reduced. So far as concerns purely national policies to combat depression or stagnation, the emphasis would be turned from monetary therapy to removing the institutional and psychological causes. An individual country could still experience monetary changes through events in other economies; but the magnitude of these sympathetic movements would be vastly reduced relatively to a system of independent national credit reserves, and they could probably be effectively "managed" through appropriate open-market and fiscal operations.

For the world we live in, an international system of such Spartan severity probably has illustrative significance only: it indicates what would be necessary for a really automatic system, and alternatively by the same token, how large a field must either be left to the self-interest of particular countries or surrendered to international control. Besides the revolution in financial institutions which would be entailed by 100 per cent reserve money, there is an ultimate doubt as to whether private persons and firms would not simply take over the creation of credit

[5] F. A. von Hayek, *Monetary Nationalism and International Stability* (London, 1937), Ch. 2.

from the banks, and whether national reserve systems would not thus continue under still less manageable auspices. Still more fundamental is the misgiving that, as long as we have so inadequately coped with the underlying *real* causes of depression, we shall have to leave some latitude for monetary therapy at the hands of each country individually. It may be that in the near future labor will cease to be content with an advance of money wages which is either accompanied by lessened real wages or by a lag of the latter behind increases of productivity. In this event, the question of real wages will have to be threshed out explicitly, and monetary expansion will lose much of its potency. As long, however, as labor fixes its attention primarily on money rates and as long as monopoly, taxation, and other institutional factors continue to curb the propensity to invest, national authorities will probably not surrender the weapon of monetary expansion; and by the same token the fixed exchange rates of a truly automatic international money or even of the historical gold standard become—except for rather short periods—impossible.

The international currency problem thus appears to be essentially the elaboration of some sort of compromise between a really homogeneous international money and completely separate and unrelated national systems. On the one hand we cannot, for reasons already adduced, expect an automatic system "where the whole world possessed a homogeneous currency such as obtains within separate countries and where its flow between regions was left to be determined by the results of the actions of all individuals."[6] On the other hand, we cannot face the continuance of the isolation of national economic systems which the monetary and commercial policies of the past decade produced. The compromise position will involve a surrender of national power, partly to general rules and partly to discretionary authority. But the very intricacy of the compromise between a thoroughgoing international system and a congeries of purely national systems makes it difficult to believe that much of the terrain can be effectively covered by general rules; the role of administrative authority would seem necessarily to be large.

Unfortunately it is not possible to permit these sentences to carry particularly optimistic implications. Professor Williams may be right in believing originally in the greater promise of the informal "key nations" approach, and later in evincing some skepticism even as to agreement between America and England. There may furthermore be a danger in launching the Fund operations in the midst of heavy reconstruction demands for capital. On the other side, however, stands the fact that the reform spirit engendered by a war ought to be exploited

[6] Hayek, *op. cit.*, p. 4.

in pushing international collaboration to the utmost. The point of emphasis here lies aside from these matters: the issue of sovereignty cannot be avoided by an international monetary automaton, gold or otherwise, nor by the beguilingly tactful treatment accorded it by the published plans, particularly by the English version. The issue requires explicit settlement.

## II

In their present formulation the currency plans do not go much farther toward an international monetary system than to propose the elimination of the nationalistic excesses of the thirties. In itself this would be a substantial accomplishment, for the inescapable necessity of only gradually attenuating the war controls of foreign trade and finance during a period of renascent private enterprise immediately after the war would otherwise open the door to those discriminatory practices which a decade ago were reducing international economic intercourse to the vanishing point. It is therefore not derogatory to emphasize that the currency schemes would re-establish the plane of international competition which prevailed before the world financial crisis of 1931. Indeed, under favorable conditions the plans could induce improvements over that level.

In their present form, the plans seem to contemplate a certain reduction of national sovereignty, in the first place by submission to rules, and in the second place, but to much smaller degree, by submission to the Fund authority. My own belief is that, even within the relatively modest field within which money would be internationalized by these plans, the role of authority will have to be extended. Aside from that—and this is another subject for which some footnotes will later be offered—the further realization of internationalism in monetary matters will require further extensions of discretionary authority.

As matters stand in the revised White plan—and there is substantial accord on these basic matters between the English and American proposals—the member countries of the international stabilization fund would subscribe to several more or less categoric obligations: (1) They would agree to maintain exchange rates within a range fixed by the Fund and in general not to alter exchange rates except with the approval of the Fund. During the first three years a member would be allowed to alter its rate by 10 per cent after consulting the Fund. (2) They would agree to abandon as soon as possible all restrictions over foreign exchange transactions (other than those involving capital transfers) and not to impose additional restrictions without the approval of the Fund. (3) They would agree not to enter on any new bilateral clearing arrangements nor engage in multiple currency practices not

approved by the Fund. Beside the limitation through these rules, national sovereignty would be subjected to some degree of discretionary authority which the Fund would exercise as a banker; that is, powers deriving from the creditor's prerogative of laying down conditions for a loan. In this capacity the Fund can prescribe measures to correct a balance of payments disequilibrium on the part of a prospective borrower, and require a country using the Fund to control capital exports.

Intelligently utilized, these rules and powers are all to the good, but much could be done to make their interpretation more explicit in advance of actual application. Changes in exchange rates are to be permitted by the Fund *when essential to the attaining of fundamental equilibrium;* but nothing explicit is said concerning the character of this equilibrium. This could become a serious matter. In some quarters, for example, there is a predilection to define equilibrium even for foreign exchange purposes as a state of full employment; and upon the basis of such a concept almost all of the beggar-my-neighbor devaluations of the thirties would have to be permitted. Does equilibrium include or exclude gold exports from a gold producing country and their receipt by other countries? True, this is a technical detail, but it involves the acquiescence of the Fund or the repudiation of an indefinitely protracted American support of the world gold production. Does equilibrium include or exclude the movement of other than new gold, the movement of capital? The Fund could scarcely condone changes in exchange rates to prevent "normal" movements; but does this not inevitably imply discretionary authority on the part of the Fund as to what is "normal"? This is already clearly implied in the power of the Fund to require control of capital flights, but the plans limit the application of the power to countries borrowing from the Fund. A gold or capital movement is pathological because of current causes, not because the flight country at some time managed to become indebted to the Fund. Yet apparently as a concession to practical politics, the plans have had to limit the Fund's discretion on this head to its role as banker.

No less compelling reasons exist for an extension of administrative power—still under the rubric of the present delineation of general functions entrusted to the Fund—when we contemplate exchange rate revisions. The plans seem definitely to repudiate the philosophy of free exchange rates; they set limits to one-sided action;[7] and they imply that such changes would, after the initial experimental period, be matters of rare resort. But if rates are not to be completely flexible, if revisions are admitted only for structural economic changes—long-run productivity, demand, and demographic trends—and for unusual epi-

[7] The Keynes plan would allow unilateral changes by 5 per cent whereas the White plan would allow unilateral changes, only for the first three years, by 10 per cent.

sodic occurrences, but not for continuing business cycle variations, does not consistency require that the Fund have power to limit the frequency of change even within the permitted range of unilateral action?

One of the respects in which the current plans go beyond a restitution of pre-1931 monetary relations between nations is the prevention of disruptive capital movements, though it should be recalled that the regulation is obligatory only upon Fund borrowers. If the Fund requires the imposition of exchange control for this purpose, does it leave the details of management entirely to the national authorities? One would infer as much from the relevant passages, and practical politics may again dictate national autonomy. But this can have unwelcome and indeed disastrous consequences. Government monopoly of exchange dealings, which would certainly be instituted—perhaps of necessity—in many countries, permits all sorts of subtle pressures, political and economic, in the allocation of exchange. The English have declared that it should be possible to control capital exports without submitting each operation to the prior approval of the authorities;[8] but elsewhere this may not be possible, and again the threat to civil liberty cannot lightly be dismissed. Will it be open for a country to distinguish as it chooses between "Devisen Foreigner" and "Devisen resident," between permissible and prohibited transfers in foreigners' bank accounts, between allowable direct investments in branch plants abroad and the illicit foreign investment of foreign earnings to escape the capital export embargo? All of these appear to be matters of vital international concern and a proper sphere of oversight by the monetary umpire. The same observations would apply to the national rationing of scarce currencies, now expressly exempted from Fund interference.

The pledge of member countries, contemplated in the White plan, not to impose new restrictions on foreign exchange transactions without Fund approval ought to be construed to permit nondiscriminatory defensive exchange control under extraordinary circumstances. Thus the position of neutrals in wartime often requires precautionary measures against inflation through strongly favorable balances and an influx of gold or foreign exchange. The inflation occurs directly, not necessarily through broadening the credit base, and central banks could carry through a compensatory deflation in the domestic credit structure only with great (and uneconomic) pressure on innocent bystanders. To cut loose from the existing gold or gold-exchange standard and permit a national currency appreciation may be the remedy, as in the case of Sweden in both the last and present wars;[9] but the remedy is not al-

[8] "The Return to Foreign Banking," *Economist*, Banking Sup., Nov. 13, 1943, p. 5. But for the contrary conviction, see "The Future of the Exchanges," *Economist*, Jan. 2, 1943, pp. 3-5.

[9] Cf. *The Financial News* (London), July 9, 1943, p. 2.

ways available. Switzerland may need to have especial regard for exchange stability because of her international financial position, and the less onerous measure appears to be limitations upon the amount of dollar exchange which Swiss banks and nationals are permitted to buy against francs. Most South and Central American countries face the same threat of inflation and hesitate to permit exchange appreciation, since it would be temporary and disruptive, and since the ordinary citizen regards manipulation of the standard with mistrust. El Salvador is meeting the situation by paying for a certain portion of exporters' bills of exchange in government bonds instead of cash.[10] There seems to be no good reason why the currency plans should not explicitly empower the Fund to permit nondiscriminatory exchange controls as temporary measures in situations such as these.

## III

We have been concerned with extensions of Fund authority to provide adequately for the functions already incorporated in the plans, functions which generally speaking would restore the international monetary mechanism at least to its strength before the world financial crisis of the early thirties. Under the plans, as in the twenties, competitive devaluation would be excluded as a legitimate means of combatting depression; discriminatory exchange control and multiple currencies would not disrupt the international price structure; the foreign exchange resources of the Fund would rehabilitate to greater or lesser degree the international short-term capital market; and the regulation of capital exports would eliminate flights. But there is nothing in all of this to eliminate the ultimate causes of capital flights and "hot money," structural weaknesses in the foreign exchange positions such as that of sterling in the late twenties, or world economic depressions. More is necessary. And even if the present currency plans already press upon the limits of national political tolerance, it is still true that more is necessary.

A dramatic and fruitful extension of the Clearing or Fund authority would be to endow it with a general power to initiate changes in exchange rates now attaching only to the Fund's general control over the conditions to be satisfied for a loan. As long as the international monetary authority has only the indirect control over national monetary and fiscal policies inhering in its powers as a creditor, the ultimate recourse otherwise is to adapt the external to the internal value of the particular currency. This does not argue in favor of free exchanges; on the contrary, the international authority, as Keynes has recently argued,[11]

[10] I am indebted to Mr. Robert Triffin and Señor Manuel Valdez for their observations on Latin-America.

[11] J. M. Keynes, "The Objective of International Price Stability," *Economic Journal*, June-Sept., 1943, pp. 185-187.

would first bring to bear its power as banker and its prestige as exchange rate arbiter to induce the particular country to pursue fiscal and monetary actions which do not require exchange rate revision. But if this course is undesirable or if the Fund's recommendation is simply ignored, international equilibrium requires that a rate be enforced which equalizes the balance of payments without one-sided gold, exchange, or capital movements.

Neither the judgment nor the disinterestedness of a particular country can be relied upon. A government may maintain an overvalued rate for the national currency to avoid a "loss of face" through devaluation, to prevent a rise of the value of the foreign debt, to secure an artificial advantage in terms of trade, to make foreign exchange scarce and thus withdraw imports from free public choice and deliver them over to rationing or to state schemes for armaments or autarchy; it may tolerate an overvalued rate as a concession to popular prejudices, or because it hopes to be able subsequently to justify the rate through expanding output and exports. It is fatuous to hope to cover this kaleiodoscopic variety by rule. Is not administrative disposition a fundamental necessity? As long as the Interstate Commerce Commission could review but not inaugurate railway rates, effective control proved to be impossible. An international monetary authority would inevitably go through the same evolution.

Both the American and British plans provide for uniform changes in the gold value of currencies, but the approval of 85 per cent of the member votes is required under the White plan. There would appear to be no field where the particular and the cosmopolitan interests diverge so dramatically, and where therefore the need for objective authority is so great. I do not mean to decry the linking of national currencies or the international unit to gold, for the prestige which gold enjoys in the popular mind should be exploited to lend solidity to the monetary systems. In fact, of course, clearing balances in gold differ in no essential respect from clearing without gold; but "thinking makes it so" that the former is superior. But this reflection offers no iota of justification for the vast outpouring of resources, even in the midst of war, into new gold production. The unseemly truth is that the free-enterprise gold producing economies are the victims of their own gold producing interests, and that this fact in turn becomes a datum for a collective economy such as Russia. As long as the chief gold producing countries have much more than 15 per cent of the votes, the contrast between Fund decisions and producers' desires might prove to be academic. It is, of course, not certain that production will remain as it is—witness the prospective decline of the Rand gold output within a decade to negligible proportions—nor is it written that the individuals participat-

ing in Fund decisions will continue indefinitely to represent solely the producers' interests. But the revision of the gold price by simple majority would be a step in the right direction.

It would seem also that the monetary plans should make explicit provision for the definition of currency units not merely in gold, but also alternatively in terms of another currency or even in terms of a composite of several foreign currencies. A small country with particularly strong financial or trade ties with a large economy may find greater assurance in a standing provision for the automatic movement of its unit parallel to the dominating economy or economies than in the possibility of petitioning the Fund on every occasion for a redefinition of the unit in terms of gold. To discourage the formation of large currency blocs, it would be desirable to make this arrangement dependent upon Fund permission, to be given only upon a demonstration of the necessities of the particular case.

## IV

A really international monetary system implies a genuinely international price system, and that in turn implies that isolated national markets give place to international markets. Consequently an international clearing union or stabilization fund is an empty façade, without complementary changes in commercial policy to permit the free movement of goods. But the cost of greater gains from international exchange is a greater vulnerability of the domestic economy to outside influence. At an earlier juncture it was suggested that the complete suppression of national monetary reserves and commercial credit expansion would end the vulnerability of one country to foreign monetary policy, simply by obliterating all national monetary policies. Such a system is far from the present world; and consequently the vulnerability of the home economy remains.

It has been the thesis of the present paper that we cannot have the better part of two worlds. If we wish to see a rehabilitation of international trade and finance we can do so only by a surrender of national sovereignty, the greater the more the system is international. As in all cases where a larger political entity is erected upon smaller ones, a part of the relations of the members can be governed by rules and objective norms. But law cannot function without equity, and the larger economic whole cannot function without central administrative power. Only by sacrificing prerogatives does the individual secure immunity from the unbridled exercise of prerogatives by others.

## DISCUSSION

Redvers Opie: I find myself in substantial agreement with Mr. Ellis' paper, but I should like to make certain changes in emphasis which are important to a clear understanding of the purposes of international monetary co-operation.

The question of sovereignty has been misunderstood by the public and aroused opposition to the schemes. Therefore we must be clear about the effect of an international scheme on the exercise of sovereignty by national monetary authorities. Sovereignty is indivisible. It is not a question of surrendering sovereignty but of exercising it with discretion in the light of true national self-interest. There is no unescapable conflict of interest between nations in monetary matters nor is it necessary to envisage a supranational authority to achieve the purpose of international monetary collaboration. To avoid conjuring up wrong and frightening images in the public mind, I would insist that "international" and not "supernational" is the right word to use in describing agreements between nations to pursue one policy rather than another. International agreement may mean less rather than more control by the national authorities, which remain the repositories of control. Agreements may proscribe certain acts by sovereign powers, such as restrictions on imports, the effect of which would be to divert arbitrarily the flow of trade. Yet no supranational authority intervenes. To bring out this point in describing the functions of an international scheme, instead of saying with Mr. Ellis that national power is surrendered to a "discretionary authority," I would emphasize "agreement by consultation." There need be no question of transferring the functions of national monetary authorities to an international authority. In fact I would eschew the word authority in describing international institutions and instead emphasise their consultative nature, and their purpose as persuading countries in their own enlightened self-interest to concert action in the common interest.

The provision of machinery for *continuing* consultation between countries constitutes the most general and probably the major objective of an international scheme. Mr. Ellis has suggested that international monetary arrangements would inevitably go through a process of evolution. This is inevitable, because it would be visionary to expect countries suddenly to accept categorical obligations of a kind which vitally affect their economic policy. The diversity of economic, administrative and political conditions as between countries alone would suffice to make it unrealistic to ask for irrevocable commitments regarding the exercise of sovereignty. Much more is to be expected from the gradual evolution of sound policies by the consultative method in which each will benefit from the wisdom of all, and the wiser will teach the more foolish.

I do not believe that the nature of international collaboration in *monetary* matters is best shown by contrasting the present state of related, though autonomous, national monetary systems with some ideal system in which money would be fully internationalized and the international system put "beyond the influence of national monetary policies." Fascinating though it may be to speculate on what would be the nature of an international monetary

system if each country adopted 100 per cent gold reserve money and invariable international parities, I do not think that this kind of speculation should be carried very far. It soon becomes as bewildering as the Clarkian static state, and just as fruitless. And as I think Mr. Ellis implies, although such a theoretical automatic system might free an individual country from the influence of foreign monetary policies (since the latter by hypothesis would not exist), it would still be vulnerable to the impact of changes in other parts of economic policy abroad.

The nature of the problem of collaboration is better described by showing the need for each country to take account of the impact of its own monetary policy on other countries, with the expectation that this will contribute to other countries doing likewise. I agree with Mr. Ellis in accepting "monetary therapy" as a legitimate instrument of national policy. Money cannot be neutral in an imperfect world, and the monetary instrument properly used can be a valuable offset to the activity or inactivity of other elements in the economy. In this connection, within an international monetary scheme devaluation might be regarded as a sign of failure in concerting action between nations, but nevertheless as an acceptable method of adjustment to a *de facto* situation which cannot be wished away, although at the same time devaluation might well be frowned upon if it were used to achieve ends which could be attained by more appropriate means. Devaluation cannot be outlawed but it can be made by agreement to conform to rules of good behavior.

I would go further than Mr. Ellis in defending the link with gold. There is more in the case for retaining it than "the prestige which gold enjoys in the popular mind" or than is implied in the statement that clearing in gold is superior because "thinking makes it so." Not that *auri sacra fames* is unimportant. But the link with gold also gives an objective test of sound monetary policy and provides a visible bridle to check unwise monetary authorities, or alternatively to provide them with evidence against the political opponents of sound monetary policy, which in some countries at least is indispensable.

Mr. Ellis coupled commercial policy with monetary policy as the causes of economic isolation, thereby indicating that he does not expect sound monetary policies to cure all economic ills. This cannot be emphasized too much, and when Mr. Ellis, in discussing capital exports, states that there is nothing in the plans so far published "to eliminate the ultimate causes of capital flights," I assume that he means that it was not intended that there should be. These could not be removed in a monetary plan, except the one cause—distrust in the stability of the currency. And this cause, it is one of the main objectives of an international scheme to remove.

I have not had the privilege of reading Professor Williams' address and therefore my comments are based entirely on his two articles in *Foreign Affairs*,[1] the second of which expounds more fully some of the points contained in an earlier article.

Professor Williams has rendered a valuable service in clarifying the nature of the problems in the transitional period immediately after the war and in

[1] *Foreign Affairs*, July, 1943, and Jan., 1944.

distinguishing them from the problems with which we expect normally to be confronted. The clarification has lessened his own doubts about the currency plans and it is to be hoped that it has lessened other people's, too. It would be fantastic to assume that the cessation of hostilities will bring a magic change in economic conditions. The aftermath of war, with the need for reconversion from war to peace production, is full of extraordinary difficulties which can only be met by extraordinary measures. A gratifying difference between sentiment in all countries now and after the last war is the conviction that the transition, if it is to be orderly, must be controlled, by the retention and adaptation of wartime controls and their gradual relaxation.

But in my opinion Professor Williams exaggerates the conflict between the aims in the transition period and in the long-run. It is true that the lending facilities of the monetary plans are unsuitable for many purposes in the transition period. Relief, special reconstruction loans, or other extraordinary facilities will no doubt be required; but it should not be forgotten that short periods merge imperceptibly into long periods, in practice as in economic theory. It will not be easy to detect when so-called "normal conditions" have arrived or when countries which have learned the reconstruction walk are ready to run. Excessive caution or lack of confidence may prevent them from ever running. This is where a currency scheme might play an important part in the transition period. By giving countries relative assurance that external facilities will be available, much may be done to encourage them to get rid of controls and to increase imports all round, instead of cutting down on them or only very cautiously allowing them to increase. And since imports are the obverse of exports, expansion rather than contraction would then be the world pattern. The certainty of having a given amount of rope is the important desideratum, not the anonymity of the hangman who provides it. For this reason, even in more normal conditions stability would be promoted if countries could be given reasonable assurance of moderate assistance in extending the time over which they balance their international accounts, instead of living under the fear that existing short-term loans might suddenly be cut off. I regard this as the second main purpose of an international monetary scheme, the first being to provide the continuing machinery of consultation. It undoubtedly raises difficult questions in agreeing on the method by which the scheme would exercise its "lending function," and this is the one respect in which an international organization would perform a function which might otherwise be performed by individuals or by national agencies if short-term credits were intergovernmental. But it should not be impossible to devise rules which would satisfy all countries.

I agree with Professor Williams in rejecting the view that a domestic policy in pursuit of full employment is not likely to have repercussions abroad which in turn affect the originating country, or that these repercussions may be ignored. But with a full international scheme, there is likely to be more regard to the interest of other countries and more concerting of policy than without it. Political factors in determining economic policies are not likely to be more troublesome, or devaluation as a measure *in extremis* to cope with a situation that has already arisen is not likely to be more frequent and the

resulting losses greater, with than without an international scheme. On the contrary, consultation between nations to improve the rules of the game should curb excesses and reduce errors; and while there might remain a bias against a major deflationary operation, and in favor of devaluation, to remedy a serious *de facto* disequilibrium, therapeutic doses of deflation and of inflation would be taken more frequently if the doctor were always on hand to give advice. Let us at least try an international scheme before we give up a system of multilateral trade on the easy assumption that it is incompatible with that degree of rigidity in domestic cost-price structures which existing political conditions are likely to impose.

I see no conflict between the key country approach and the establishment of a full international scheme. Professor Williams himself emphasises the responsibility of the major industrial countries to take the lead in establishing world economic conditions which the younger countries have little power to control. He is in favor of allowing the younger countries latitude to vary their exchange rates. Within an international scheme the responsibility could be exercised and the latitude allowed. Indeed, unless major countries lived up to their responsibility, an international scheme would not work. Moreover, the practical necessity of bringing countries into the scheme only as conditions made it possible for them to conform to the rules would, in actual fact, as Professor Williams recognizes, make for similarity between the key country and the full international approach.

Finally, I remain unconvinced by Professor Williams' contrast between the harmony which prevailed when England was the world's leading lender and the disharmony that is likely to pester the twentieth century creditor. Apart from the question of faith in the invisible hand or skepticism that this particular harmony of nature should have suddenly ceased to exist around 1900, I see no reason why there should be a lack of demand for American exports; or why a "mature" creditor country with an excess of imports should find it easier than a young lender to make a multilateral system work; or why, given a reasonable commercial policy, there should be any deficiency in America's demand for imports when that country becomes a mature creditor.

Frank D. Graham: It would be more than regrettable if, as is not improbable, disagreements on procedure should totally frustrate the present efforts to improve the international monetary mechanism. I have little sympathy with those who confine their criticisms of these efforts to a sweeping indictment without a single constructive note. We need to reconcile our differences and Dr. Ellis is so persuasive, so sincere, and so urbane, that one feels a sense of churlishness in opposing him. But I must own that I felt concern over his very first paragraph and my uneasiness increases rather than diminishes at what he goes on to say. I shall try succinctly to define the issue between us and shall discuss it in the conviction that we must be clear on fundamentals if we would hope to prevent devastating disillusionment.

Dr. Ellis says that if it were realized that an international standard or system necessarily means control, and that international necessarily means supernational, agreement on a desirable (international) system would be facilitated.

I do not think that this is true. I know that I for one (and I suspect that in this, at least, I am not a lone wolf) would deny both the premises and the conclusion. I would reject any supernational scheme as both inherently undesirable and quite unnecessary to full economic and financial co-operation among the nations.

I believe that monetary sovereignty is a legitimate and indispensable aspect of nationality and that its exercise is not incompatible with the interests of other countries or of the world as a whole. It is alien to the notion of sovereignty to suppose that the possessor of it is precluded from acting in his own interest merely because his interest leads him into courses which are not independent of those elsewhere pursued. When, in the late nineteenth century, most countries adopted the gold standard, on what they conceived to be their own interest, they imposed upon themselves some limitation of their freedom of action in the monetary sphere (so long as they desired to adhere to that standard) but they can hardly be said, in so doing, to have impaired their sovereignty. I do not think they would necessarily have impaired their sovereignty even if they had entered into an international convention to adhere to the gold standard. When Professor Ellis uses the phrase voluntary submission to describe their action one might ask submission to whom and what? I conceive that submission to the will of another would be an impairment of sovereignty, even if it were voluntary, but surely one cannot assert that submission to one's own will deprives one of sovereignty or anything else. The world would surely be still more quixotic than it now is if, with appropriate chest-thumpings, we should insist upon our unalienable right to defy our own will.

The most doctrinaire conception of sovereignty could scarcely go beyond the assertion that sovereignty might be impaired, even by voluntary action, on a contract which was irrevocable over a certain period of time. Such a contention, however, would be hard to defend since nations which indisputably regard themselves as having maintained sovereignty have frequently entered into such compacts. One might therefore suspect that sovereignty is maintained so long as external force is not successfully applied to a given end. The essense of sovereignty, in my judgment, is uncoerceability (a barbarous but indispensable word).

The sanctions hesitantly introduced in the Keynes and White plans are designed to make the plans, however weakly, supernational. Since, however, an untrammeled control of monetary policy is of supreme importance where pecuniary profit is the motivating force in economic activity it seems to me that no important capitalistic country would enter the plan except under misapprehension of its nature or a conviction that it can dominate its management. As things now stand, under both the Keynes and the White plans, every country entering the association is asked to endorse in advance an unspecified policy over which it may have no control whatever.

The international gold standard was never managed (in the modern sense of the word, viz., an attempt to influence the long-run value of the monetary unit) until after the war of 1914-18. It is just because several nations would not stand for this sort of management, by a dominant country, that the gold

standard broke down. The various countries had been willing to adopt a currency that *no* one managed but they would not stand for management of their currency by some other nation. Nor, until the world is ready for a supernational general government, will it ever be ready for a supernational monetary authority.

It is relatively easy for two countries to get together on a given monetary policy and I am, therefore, favorably disposed to Professor Williams' key-countries approach. But, if fixed exchange rates are desired, it should be recognized that they must agree in advance on some monetary policy, or one of the countries, in the effort to maintain fixed rates, will inevitably be subject to the other. It is reckless to plump for fixed exchange rates without any consideration of national monetary policies.

I believe that fixed exchange rates are a shibboleth and that their importance is greatly exaggerated. Provided exchange rates moved appropriately, the internal monetary policy that any country might pursue would not be a matter of primary concern to any other country. Sanctions might well be brought to bear on any country that deliberately manipulated its exchange rates in pursuit of a beggar-my-neighbor policy, whereas any country attempting to maintain an equilibrium rate might well be supported by a co-operating bloc, but I see no reason for any control that goes farther than this. All that in the international interest we need to do is to check predatory monetary policies. This is no reason for insisting that national policies be identical. This, however, so long as we are bent upon fixity of exchange rates, is the strait jacket that we would impose on all countries entering the consortium. Dr. Ellis, sensing the difficulties, feels that we must draw the strings still tighter. I am, on the other hand, convinced that the only solution is to relax them.

The international financial collapse of the early thirties is very largely attributable to the effort, in preceding years, to keep exchange rates fixed in a regime of divergent monetary policies. But, in complete disregard of this evidence of the folly of seeking stable rates, rather than stability in the relationship between rates and the relative purchasing powers of the several currencies, we seem bent on repeating the errors of the later twenties.

I am opposed to controls which do not clearly expand the sum total of freedom. I presume that Professor Ellis' answer to the question in his title ("Can National and International Monetary Policies be Reconciled?") is that it is impossible and that we must therefore have supernational control to prevent chaos. I do not think that it is impossible if we are not determined to have fixed exchange rates. I wonder whether in pursuing that object we are not dropping the bone of stability for the shadow. Flexible exchange rates are perfectly compatible with a free, full, and stable international trade provided the movements of exchange rates are confined, as they could be, to functional fluctuations.

# MINUTES OF THE BUSINESS MEETING OF THE AMERICAN ECONOMIC ASSOCIATION HELD IN WASHINGTON, D.C., JANUARY 22 AND 23, 1944

The business meetings of the Association were held January 22 at 9:00 A.M. at the Statler Hotel and January 23 at 7:30 P.M. at the Department of Commerce Auditorium, President Wolfe presiding.

The minutes of the meeting of January 6, 1943, were approved as printed in the *Proceedings of the Fifty-fifth Annual Meeting*, pages 473-474.

The following reports were submitted and ordered printed:

1. The Secretary. (See page 404.)
2. The Managing Editor. (See page 411.)
3. The Treasurer. (See page 414.)
4. The Finance Committee. (See page 417.)
5. The Auditor. (See page 419.)

The report of Mr. C. Reinold Noyes of the work of the National Bureau of Economic Research is found below, but no formal reports were submitted by our representatives to the American Council of Learned Societies and the Social Science Research Council.

It was voted to accept the Report of the Committee on the Focusing of Informed Opinion (F. D. Graham, Chairman) and to refer this report back to the Executive Committee for further consideration.

The actions of the Executive Committee as recorded in the minutes were formally ratified.

The following report of the Committee on Resolutions was read and approved:

WHEREAS, The members of the American Economic Association, meeting in the fifty-sixth annual session, January 20-23, 1944, in Washington, D.C., desire to express their appreciation to those who have contributed to the success of the session; therefore be it

*Resolved,* That the Secretary be instructed to convey the sincere thanks of the Association to President A. B. Wolfe, Dr. Marshall E. Dimock, and Dr. G. Lyle Belsley for the preparation of the very interesting program, and to the participants in the program for their valuable services; and be it further

*Resolved,* That we extend to the officers and members of the American Political Science Association and the American Society for Public Administration our appreciation and gratitude for their co-operation and participation which contributed greatly to the success of our meetings; and be it further

*Resolved,* That we extend to Dr. W. Reed West and Dr. Amos E. Taylor our thanks for the thorough and excellent preparations made for the meetings and for the efficient handling of detailed arrangements; and be it finally

*Resolved,* That we extend to the Department of Commerce, the George Washington University, and the management of the Statler Hotel our thanks for making available their facilities for our meetings.

Raymond T. Bye, *Chairman*
Paul A. Dodd
D. Stevens Wilson

The Secretary presented the certification of election:

In accordance with the bylaws on election procedure, I hereby certify the results of the recent balloting, and present the reports of the Nominating Committee and the Committee on Elections.

The Nominating Committee, consisting of Sumner H. Slichter, Harvard University, Chairman, Paul M. O'Leary, Office of Price Administration, Robert W. Elsasser, Tulane

University, Spurgeon Bell, National Resources Planning Board, Robert A. Gordon, University of California, and Lawrence H. Seltzer, Wayne University, presented to the Secretary the list of nominees for the respective offices.

For President
Joseph S. Davis
For Vice-Presidents
Edward H. Chamberlin
Charles O. Hardy
Joseph J. Spengler
George W. Stocking

For Executive Committee
Norman S. Buchanan
Frank W. Fetter
Theodore W. Schultz
Donald H. Wallace
For Social Science Research Council Representative
Simeon E. Leland
Arthur R. Upgren

The Committee on Elections (Garfield V. Cox, Chairman, Arthur R. Tebbutt, and James Washington Bell) prepared biographical sketches of the candidates and ballots were distributed early in December. The canvass of ballots was made on January 15, and the results were filed with the Secretary.

From the report of the Committee on Elections, I have the following information:

| | |
|---|---|
| Number of envelopes without names for identification | 10 |
| Number received too late to count | 7 |
| Number of defective ballots | — |
| Number of legal ballots | 1,405 |
| Number of returns from the mail ballot | 1,422 |

On the basis of the canvass of the votes cast, I certify that the following persons have been duly elected to the respective offices:

President (for a term of one year)
Joseph S. Davis
Vice-Presidents (for a term of one year)
Edward H. Chamberlin
Charles O. Hardy
Members of the Executive Committee (for a term of three years)
Frank W. Fetter
Theodore W. Schultz
Representative to the Social Science Research Council (for a term of three years)
Simeon E. Leland

James Washington Bell, *Secretary*

It was voted to refer to the Executive Committee, with power to act, the time and place and character of our meetings in 1944.

Adjourned.

# REPORT OF THE SECRETARY FOR THE YEAR 1943

The following report includes minutes of the Executive Committee (the second and third meetings of the 1943 Committee and the first of the newly constituted Committee for 1944), together with brief comments on some of the activities and operations of the Association during the past year.

1. Minutes of the second meeting of the 1943 Executive Committee:

The second meeting of the 1943 Executive Committee was held at the Biltmore Hotel in New York City, March 19-20, 1943. The meeting was called to order Friday, the 19th, at 1:00 P.M., recessed from 5:00 to 7:00, reconvened at that hour; recessed at 12:00 to meet again on Saturday morning, the 20th, at 10:00 A.M., and was adjourned at 3:30 P.M. Present were President Wolfe, presiding, Bell, Crum, Edwards, Homan, Leiserson, Mills, Nourse, Shoup, Slichter, L. L. Watkins and M. W. Watkins. Members of the Nominating Committee were called in joint session Friday evening and were invited to attend the meeting of the Committee on Saturday morning. Also, by invitation, as representative of the Association on American Council of Learned Societies, Professor F. H. Knight attended these sessions and Professor J. M. Clark attended the meeting on Saturday morning.

The minutes of the Executive Committee meetings of January 5 and 7, published in the *Proceedings*, page 476, were read and approved.

After preliminary remarks by President Wolfe, reports were heard from the Managing Editor and from the Secretary-Treasurer. In view of the absence of a number of members at the Washington meetings, these reports were repeated in full and formal votes were taken on that occasion to regularize the actions of the Committee.

It was voted to accept the report of the Managing Editor and to approve the expenditures in excess of the 1942 budget allowance. Note was also taken of the lack of reconciliation of figures in this report with those found in the Auditor's Report. The appointment of Professor Mabel Newcomer on the Editorial Board for a full term was approved. Miss Newcomer has served during the past year in the place of Professor Harold M. Groves, resigned. The appointment of Professor George N. Halm to succeed Professor E. A. Kincaid, whose term expired December 31, 1942, was also approved.

Professor Homan, Chairman of the Committee on the Blakiston Project, read the report published in the March *Proceedings*, page 496. Professor Homan asked that his resignation, previously tendered, be accepted. In accepting the resignations of both Professors Homan and Douglas Brown, a vote of thanks was moved and passed for their faithful and efficient service on this Committee. The nomination of Professor Howard S. Ellis as Chairman of this Committee was approved. With the Secretary, Professor Bell, serving ex officio, there remains one vacancy on this Committee still to be filled.

The Treasurer read the report printed in the *Proceedings*, pages 486-487, and the report of the Finance Committee, pages 488-489. These reports were approved.

The Treasurer then summarized the current financial condition of the Association and reported the refund of the advance made by the Social Science Research Council referred to in the minutes of January 7, 1943.

Copies of the Auditor's Report were again submitted and a supplementary report from David Himmelblau and Company was presented, suggesting improvements in our accounting methods and a system for reconciling our accounts with those of the Washington office. The Secretary was requested to write a letter of appreciation to David Himmelblau and Company for the painstaking care and thoroughness of the audit.

A report was read from the Committee on Economists in the Public Service, M. A. Copeland, Chairman. It was voted to accept the report and to continue the life of the Committee with the request that attention be directed to the kinds of training in economics needed in the government service. As a subject of collateral interest, it was suggested that the kinds of training given economists at colleges and universities is incidental to the activities of the Committee, but this change was not included in the motion.

The Secretary read excerpts from Exhibit III of the Secretary's report (*Proceedings*, pages 481-483), relating to the wartime adjustments in the economics curriculum of American colleges and universities, which opened up a general discussion on the teaching of economics; i.e., what is being taught and what should be taught, both during the war and postwar periods. The Secretary discussed the activities of the National Foundation for Education, the projected survey of the teaching of government under the auspices of that Foundation, and of the popularization, by means of pamphlets, of vital topics promoting intelligent citizenship. Professor Wolfe tied up this question with the annual

program of the Association and suggested that a committee be constituted to give further consideration to the following problems: the contents of the elementary course in economics and other courses for the war and postwar periods; integration of economics and other social science subjects; co-operation with other associations and foundations in promoting education in economics.

The President and Secretary were instructed to select a representative of the Association to the Quadricentennial Celebration of Copernicus and to draw up a testimonial statement for the occasion.

No action was taken with regard to the appointment of a representative of the Association to the Foundation for the Study of Cycles. It was pointed out that several prominent members of the Association are included amongst the names of the Committee of Advisers and that no further useful purpose would be served by having the Association's name connected with the Foundation.

Plans for the 1943 meeting were discussed but action was held in abeyance pending more definite developments concerning the attitude of the ODT with regard to meetings of learned societies. Present sentiment seems to be that meetings during the Christmas recess would be inadvisable and that if a national meeting is to be held, the most appropriate dates would be in the period immediately following Labor Day. The Secretary reported September to December dates still open in Cleveland. The information was submitted by the manager of the Cleveland Convention Bureau.

No appropriations were made for 1943 convention expenditures. Appropriations for the Cleveland meeting, 1942, were reviewed and the Treasurer reported that of the amounts appropriated (for *ad hoc* committees, $1,000, plus the $750 subscribed by the S.S.R.C.; $350 for program expenses, placed in the hands of the President and the Secretary; and $200 to local arrangements committee for publicity) only $200-odd had been spent. Expenses involved in cancelling the Cleveland meeting and holding sessions in Washington amounted to some $400-$425.

Professor Wolfe raised the question of the desirability of a joint meeting with the American Political Science Association. Dr. Nourse read a letter from the American Farm Economic Association which expressed doubt about holding a meeting, but, if held, about meeting alone.

Suggestions were made for holding regional meetings. Sentiment of members present was about equally divided as between regional and national meetings. It was decided to leave plans in a flexible status with several possibilities open. For instance, a single program, consisting of main papers on selected subjects might serve as a nucleus around which regional programs could later be constructed. *Rapporteurs* or secretaries might submit summaries or abstracts of discussion of the main papers for publication in the proceedings. Regional meetings might be scheduled for (1) New England, (2) D.C., (3) Cleveland or Columbus, and at appropriate places for the (4) Midwest, (5) Southern, and (6) Pacific Coast Economic Associations.

The F. D. Graham motion (see Business Meeting minutes, January 6, 1943) was left in the hands of the President, to appoint a committee to consider the feasibility of carrying out the objects of the motion.

The balance of the meeting was devoted to the discussion of the program.

Adjourned.

## 2. Minutes of the third meeting of the 1943 Executive Committee:

The third meeting of the 1943 Executive Committee was held at the Hotel Statler, Washington, D.C., January 20, 1944. The meeting was called to order at 1:30 P.M., was recessed at 5:30 P.M., reconvened at 6:30 P.M., and adjourned at 10:30 P.M. Present were: A. B. Wolfe, presiding, Bell, Edwards, Homan, May, Nourse, Shoup, M. W. Watkins, and, by invitation, J. S. Davis.

The minutes of the second meeting of the Executive Committee, held at Hotel Biltmore, New York City, March 19-20, 1943, were read and approved.

President Wolfe read a brief memorandum concerning the activities of the officers of the Association and suggested plans for future operations. Excerpts from Professor Wolfe's remarks are included in the editorial note heading the printed program in the *Papers and Proceedings*.

The report of the Managing Editor, P. T. Homan, was presented and discussed. The editorial budget for 1944 was approved and the Editor was authorized to proceed with plans for a special supplement on postwar international economic relations or on some other equally timely subject. The appropriation for such a monograph limited expenditures to $1,500. An increase of $300 in the salary of Miss Mary Connally was approved.

The Secretary submitted a report concerning publications, members and subscribers, administrative activities, and election procedure.

It was voted to approve the policy of granting graduate or junior memberships to those entitled to such but who are now in military service and without service time counting against the three-year limit applying to such members.

A bonus was voted to Miss Tait in recognition of extra services rendered during an emergency period, October-November, 1943.

The Secretary was authorized to compensate the president of the Association to the amount of $50 for secretarial services.

The Secretary was authorized to send due bills along with election ballot material in order to save extra mailing and two-way postage.

The Treasurer submitted a report of the financial condition of the Association, a provisional budget for next year's operations, and also the Auditor's Report and the Report of the Finance Committee.

The present members of the Finance Committee were reappointed.

The following reports and memoranda were presented and discussed:

a) The Report of the Committee on Economists in the Public Service (M. A. Copeland, Chairman).

b) The Report of the Committee on the Focusing of Informed Opinion (F. D. Graham, Chairman).

c) Memoranda on teaching economics in the secondary schools, adjustment of economic curriculum to war and postwar conditions, and the activities of the National Foundation for Education.

d) The Report of the Committee on the Blakiston Project (H. S. Ellis, Chairman).

e) The Report of the Election Committee.

f) The Report of the Chairman of the Allied Social Science Associations Secretarial Group.

The matter of future meetings of the Association was left in a fluid condition pending developments.

The balance of the session was devoted to a discussion of the program for 1944.

Adjourned.

### 3. Minutes of the first meeting of the 1944 Executive Committee:

The first meeting of the 1944 Executive Committee was held at the Statler Hotel, Washington, D.C., 5:45 P.M., January 23, 1944. Present were: Bell, Davis, Edwards, Hardy, Homan, Nourse, Shoup, Slichter, and Wolfe, and, by invitation, J. M. Clark and F. C. Mills.

The minutes of the January 20, 1944, meeting were read and approved.

It was voted to appoint Professor Karl Anderson, of Bryn Mawr, to the vacancy on the Blakiston Committee, and to order the Committee to proceed with the publication of further volumes of the series.

It was voted to continue in office for three-year terms the present incumbents: P. T. Homan, Editor; James Washington Bell, Secretary-Treasurer; and John E. Walker, Counsel.

April 7-8, 1944, was tentatively set as the date for the spring meeting of the Executive Committee.

Adjourned.

## Comments on the Activities and Operations of the Association During the Year 1943

*Annual meetings.* The confusion resulting from statements of the ODT in 1942 left plans for holding annual meetings in a chaotic condition. Most learned societies interpreted the ODT request as a directive and canceled meetings for the duration. Others converted the national meeting into regional or local ones. The idea of holding national joint meetings with the other social science associations was abandoned in favor of a series of afternoon and evening meetings, running over a period of eight days (January 4-12, 1943), in Washington, D.C., where a large local membership could be served.

The decision this year to hold a joint meeting with the political science group was authorized by the Executive Committee at its spring meeting and was determined at a conference at the Shoreland Hotel in Chicago in June at which the officers of both Associations were present. The choice of Washington was again made on the ground that a large local membership would be served, and January 20-23, 1944, was selected to avoid, as far as possible, needless conflicts. It was hoped that regional or local groups might arrange concurrent meetings and programs, to be tied into the ones at Washington by arranging for the broadcasting of certain sessions. Local response did not prove to be very enthusiastic.

The character of our future annual meetings is contingent upon the exigencies of war and the attitude of ODT.

*Election procedure.* Fortunately there was no repetition of last year's delay in sending out the annual election ballot. These were mailed December 4, with a return deadline of January 7, 1944, thus allowing more than the usual time for voting. Over 1,420 ballots were received this year compared to 787 last year. A large number of suggestions for presidential nominees were written on the ballots.

*Publications.* The size of the *Review* and of the *Proceedings* has not been curtailed, and I am sure that members and subscribers will agree that the quality has also been maintained. (See Exhibit I.) Reprints of the proceedings (minutes and reports) were distributed to officers of the Association and members interested in having separate copies. The series of photographs of past presidents is continued in the *Review* and has now reached number 9. No handbook or directory has been published since 1942, but in 1944, as in 1943, a supplementary directory, including the names of all new members and some who had not previously returned their questionnaires, are published as an addition to the *Proceedings.* These sections are tipped in and can be easily torn out and affixed to the 1942 *Directory.*

The usual information booklet was re-edited and is being used to meet inquiries from all sources. Its chief use, however, is in connection with new applicants for membership.

*Placement announcements in the Review.* This section of vacancies announced and applications for teaching and other positions does not at present contain very many items, but our past experience indicates that this service has been a useful one and that we should continue to run these announcements. The importance of this service may greatly increase when we face the transition from war to peace.

*The Blakiston Project.* The volume on business cycles in this series is awaiting the completion of the bibliography, and it should soon go to press. The Committee has been reconstituted and is now working on new projects. The next volume will, in all probability, be devoted to income distribution.

*Membership.* Membership continues to increase, contrary to the experience of many other learned societies, and in 1943 we have experienced a gain rather than a decline in the number of subscribers. (See Exhibit II.)

*Economists in the public service.* Since the formation of our committee, the interest in classification and recruitment of economists in the public

service has become more widespread and has led to the formation of a more comprehensive committee in Washington, consisting of representatives from several societies in the social science group and some government agencies. This problem has many aspects, involving interests both of colleges and universities and of the public service.

*Educational survey; co-operation between associations.* The problem of teaching economics and the other social sciences in the secondary schools has been brought specifically to our attention in connection with the survey conducted under the auspices of the American Historical and the Mississippi Valley Historical Associations. We did not participate in that enterprise, but we are conscious of the existence of an important problem. Total agreement is lacking on whether or not this problem should be dealt with by some co-ordinating agency or by a joint committee of several associations.

*A.C.L.S. and S.S.R.C.* The advantages of a closer relationship between our Association and the learned councils is being recognized. Our representatives to these councils are invited to attend meetings of our Executive Committee and officers of our Association attend meetings and participate in the activities of the councils, and new fields of mutual service and helpfulness are being realized. Studies are being made by the Councils and by other associations of the relationships and the distribution of activities between the Councils and the constituent associations. Reports of the activities of the A.C.L.S. and the S.S.R.C. are not included in these proceedings but will be published and made available by the Councils to those who are interested. The report of our representative to the National Bureau of Economic Research is published below.

*Focusing informed opinion on public questions.* The report of the Graham committee, suggesting a new public service function for our Association, is provocative and should interest many of our members.

*Allied Social Science Associations.* Since the suspension of joint meetings with other associations in the social science group, the usual meetings of the secretariat of these associations have also been canceled. Your Secretary, as chairman of the group, has kept up a correspondence with other secretaries, and this useful agency will be ready to operate effectively when the social science associations again meet jointly.

*Committees appointed by the President.*

Nominating Committee
- Sumner H. Slichter, Chairman
- Paul M. O'Leary
- Robert W. Elsasser
- Spurgeon Bell
- Robert A. Gordon
- Lawrence H. Seltzer

Blakiston Project Committee
- Howard S. Ellis, Chairman

Representative on Committee on Local Arrangements
- Amos E. Taylor

Committee on Elections
Garfield V. Cox, Chairman
Arthur R. Tebbutt
James Washington Bell

Committee on the Focusing of Informed Opinion
Frank D. Graham, Chairman
Harry D. Gideonse
C. Reinold Noyes

The following members represented the Association on the occasions indicated:

Copernicus Meeting
Oscar Lange

Inauguration of Clark G. Kuebler as president of Ripon College
Anthony Cascino

*Mailing list.*

The use of the mailing list was granted to the following:

Treasury Department
Revised draft of a tentative proposal for an International Stabilization Fund

It is with regret that the names of the following persons have been removed from our active membership list, notice of their deaths having been received during the year:

John B. Andrews
Don C. Barrett
Abraham Berglund
Paul T. Cherington
John W. Cronin
Arthur M. Day
Richard T. Ely
A. M. Fox
Frederick D. Griggs
Louis J. Hopkins
Jens P. Jensen
Russell E. Johnson
James R. Kelly
Herman Kranold
Joseph N. Leinbach
Achille Loria (Honorary Member)
Frank O. Lowden
Abby L. Marlatt
Selden O. Martin
John P. Morgan (Life Member )
Maurice D. Orten
Don A. Purdy
Horace Secrist
George M. Shriver
Henry P. Shearman
Norman J. Silberling
Mark A. Smith
Henry F. Walradt
Gustavus A. Weber
Virgil Willit

Respectfully submitted,
JAMES WASHINGTON BELL, *Secretary*

EXHIBIT I

PUBLICATION COSTS

| Year* | Proceedings: Number of Pages | Proceedings: Number of Copies | Proceedings: Cost | Handbooks: Number of Pages | Handbooks: Number of Copies | Handbooks: Cost |
|---|---|---|---|---|---|---|
| 1930 | 222 | 4,300 | $1,353.91 | | | |
| 1931 | 308 | 4,300 | 1,919.18 | 88 | 4,200 | $ 589.54 |
| 1932 | 316 | 4,200 | 1,819.75 | | | |
| 1933 | 216 | 4,000 | 1,284.85 | 88 | 3,900 | 522.71 |
| 1934 | 232 | 3,700 | 1,192.91 | | | |
| 1935 | 248 | 4,000 | 1,347.88 | | | |
| 1936 | 360 | 4,200 | 2,037.90 | 58 | 4,100 | 454.36 |
| 1937 | 344 | 4,300 | 1,922.03 | | | |
| 1938 | 200 | 4,500 | 1,234.10 | 112 | 4,500 | 1,118.84† |
| 1939 | 288 | 4,600 | 1,785.91 | | | |
| 1940 | 444 | 4,900 | 2,658.12 | 108 | 5,000 | 822.58 |
| 1941 | 479 | 5,200 | 3,294.45 | | | |
| 1942 | 548 | 5,400 | 3,909.79 | 208 | 5,500 | 1,775.72† |
| 1943 | 535 | 5,500 | 3,652.56 | | | |

* This is the year of publication and pertains to the meeting of the preceding year. The figures are published in the subsequent year.

† "Who's who" volumes.

EXHIBIT II

MEMBERSHIP

| | Total 12/12/42 | Added | Removed | Gain or *Loss* | Total 12/11/43 |
|---|---|---|---|---|---|
| Annual members | 3,449 | 437* | 256† | 181 | 3,630 |
| Junior members | 122 | 36‡ | 96** | *60* | 62 |
| Family members | 28 | 11 | 3 | 8 | 36 |
| Complimentary members | 18 | 5 | 2 | 3 | 21†† |
| Life Members | 37 | — | 4 | *4* | 33 |
| Honorary members | 17 | — | 1 | *1* | 16 |
| Subtotals | 3,671 | 489 | 362 | 127 | 3,798 |
| Subscribers | 1,219 | 224 | 150 | 74 | 1,293 |
| Totals | 4,890 | 713 | 512 | 201 | 5,091 |

* Includes 79 junior members changed to annual.

† Resigned, 68; lack of address, 28; nonpayment of dues, 133; died, 26; changed to junior members, 5.

‡ Includes 5 annual members changed to junior.

** Includes 79 junior members changed to annual.

†† Includes 10 complimentary members who do not receive the publications of the Association.

# REPORT OF THE MANAGING EDITOR OF THE AMERICAN ECONOMIC REVIEW FOR THE YEAR ENDED DECEMBER, 1943

The record of the *Review* during 1943 was a satisfactory one. Articles received and published were on the whole of high quality, and many of them were of special interest because of their timeliness. Acceptable manuscripts were received in sufficient numbers to provide a volume equal in size to 1942 and larger than in other recent years.

This favorable and satisfactory situation shows signs of coming to an end. During the past few months the flow of acceptable manuscripts has diminished alarmingly. The December number was the smallest for several years past, in spite of the fact that it included all the publishable material which was at hand. The March number will likewise be small from lack of material. Unless the flow of manuscripts increases greatly above the level of the past six months, it will be impossible to maintain at the same time the recent size even at considerable sacrifice, and to maintain the quality it might be necessary to reduce the size severely. This situation is specifically called to the attention of the members of the Executive Committee and of the Association in the hope that it will aid in restoring the flow of acceptable manuscripts.

The *Review* is again greatly in the debt of the reviewers who have, on the whole, maintained the high standard which was reached in the previous year. In looking forward to 1944, it seems highly probable that the number of book reviews will again diminish since there appears to be a decided decrease in the number of new books of a character calling for notices in the *Review*.

During the year, 26 leading articles were published as compared with 28 in 1942; 30 communications, as compared with 17 in the preceding year; and 124 book reviews as compared with 138. Leading articles, communications and book reviews were contributed by 164 persons.

During the course of the year I again went at length into the subject of a revised format and early in the autumn presented a definite proposal to the members of the Executive Committee and of the Board of Editors. While the responses were on the whole favorable, there were a number of dissenting opinions supported in some instances by rather cogent arguments. This was one reason for deciding that it would be better not to introduce the proposed format without further discussion at a meeting of the Executive Committee. The other reason was that the new format was in some sense devised as a hedge against the possibility of more severe paper rationing and the consequent necessity for diminished content unless the format were changed. Due to the increasing probability which appeared toward the end of the year that the contents of the *Review* would be less, there seemed to be less need for such a hedge.

The format proposed was, in my opinion, an improvement over the present format, but it did not seem to me to be the best that could be devised under peacetime conditions. It, therefore, appeared not unlikely that within the next two or three years I should be proposing another change. Under the circumstances, it appeared possibly to be the best course to let the matter

drop until circumstances were such that any change agreed upon would be regarded as final and definitive for a considerable period of time.

In spite of entertaining this opinion, I should, however, like to have the authorization of the Executive Committee to make a change along the lines proposed last autumn if a mounting paper shortage should call for such action. Since it would be highly undesirable to make the change in size and format in the middle of the year and therefore in the middle of a volume, this authorization would really amount to no more than starting 1945 on this basis without further reference back to the Executive Committee. This step would certainly not be taken at that time unless the war appeared likely to be long drawn out and the paper shortage to be severe.

During the past three years I have continued to edit the *Review* along the conventional lines established in earlier years. This has meant that the contributions have been almost all of a highly technical character. While I feel certain that it will always remain the case that the *Review* must mainly contain materials of this sort, the question has sometimes entered my mind whether the contents should be so exclusively technical, or to put the matter the other way round, whether there might not be a place for semipopular discussions on economic problems and matters of economic policy, if the writers were of a sufficiently high level of competency. I do not have in mind any radical departure in this direction, but the question is brought up for further discussion by the members of the Executive Committee and of the Editorial Board.

It is possible at the present time to present only an approximate statement of expenses during 1943, since the appearance of the December number has been delayed and the billing has not been received. Estimating the December printing cost at $1,800.00, expenses during 1943 were as follows:

| | *1943 Budget* | *1943* | *1942* |
|---|---|---|---|
| Printing (paper, postage, reprints, etc.) | $ 8,000.00 | $ 8,279.49 | $ 8,242.57 |
| Editorial | 2,500.00 | 2,500.00 | 2,500.00 |
| Clerical | 3,200.00 | 2,944.15 | 3,129.25 |
| Supplies | 300.00 | 239.67 | 333.10 |
| Contributors | 1,500.00 | 1,739.25 | 1,625.25 |
| Contingency for increased costs | 500.00 | ...... | ...... |
| | $16,000.00 | $15,702.56 | $15,830.17 |

The total expenses, it will be seen, are approximately $200 above the approved budget for $15,500, excluding the $500 contingency. This excess may be accounted for almost entirely by the fact that the number of copies printed during the year was 1,100 more than in 1942. Payments to contributors were $239 in excess of the amount budgeted, but clerical and supply expenses were correspondingly below the budget. The expenses as listed do not include approximately $170 for the insert carrying the portraits of former presidents. There seems little point of differentiating this expense which heretofore has not been charged to the *Review* budget, and allowance is made for it in the proposed budget for 1944.

For the year 1944, the following budget is recommended:

| | |
|---|---|
| Printing (paper, postage, reprints, etc.) | $ 8,000.00 |
| Editorial | 2,500.00 |
| Clerical | 3,250.00 |
| Supplies | 250.00 |
| Contributors | 1,600.00 |
| Contingency | 400.00 |
| | $16,000.00 |

The total recommended budget of $16,000 is the same as for 1943.

The estimate for printing is based upon the assumptions that the number of copies printed in 1944 will be the same as in 1943, but that the size of the issues will be somewhat smaller. The estimate for contributors at approximately $140 less than actual 1943 outlay is also based upon the expectation of a somewhat smaller volume. The estimate for clerical expense includes a proposed increase in the salary of the editorial assistant of $300, but this is offset by cutting the amounts requested for other clerical expenses and supplies to match experience during the past year.

It had been in my mind to arrange for a supplement during 1944 on the subject of postwar international economic relations, or some other equally timely subject. It appears highly unlikely that such an arrangement can be made to come to completion during the current year. I should, however, like to feel free to proceed with such arrangements for publication in 1945, if appropriate participants can be secured. I recommend, therefore, that the Executive Committee make a contingent appropriation of $1,500.00 for this purpose.

At the end of 1943, the terms of Professor H. S. Ellis and Professor B. W. Lewis as members of the Board of Editors expired. Other members serving during the year were Professor A. G. Hart and Professor Dale Yoder, whose terms expire in 1944, and Professor G. N. Halm and Professor Mable Newcomer, whose terms expire in 1945. All the members of the Board served faithfully and well and the Managing Editor is under great debt to them.

Respectfully submitted,

PAUL T. HOMAN, *Managing Editor*

## REPORT OF THE TREASURER OF THE ASSOCIATION FOR THE YEAR ENDING DECEMBER 11, 1943

The financial condition of the Association has improved during the past year. Net income for the fiscal year was $2,798.10 compared with a loss of $1,026.62 for 1942. The difference is accounted for chiefly by the increased dues from a larger membership and by a reduction in publication expenses. Other changes were a slight increase in publication income, slight decreases in returns from investments and in administrative expenses.

Details of the results from operations are shown in the Auditor's Report, but attention may be called to the following items.

*Income.* The growth of our membership from 3,671 to 3,798 resulted in a corresponding increase in dues; namely, in round figures, $17,612 to $18,484, or $872. From subscriptions other than members the increase in income ($5,899 to $6,402) amounted to $503; from sales of copies ($932 to $1,160) $228; and from advertising, $97 less than last year ($1,505 compared with $1,602). From investments we received this year a net amount (including profit on sales) of $3,726 compared to $3,189 in 1942. From all sources, income amounted to $31,278 compared with $29,235 in 1942.

*Expenses.* Administrative and operating costs this year were $7,540 compared with $7,760, a decline of $220. Printing costs were higher for the *Review* ($9,940 cf. $9,114); lower for the Proceedings ($3,652 cf. $3,910). Editorial expenses and amounts paid contributors increased slightly. But since no separate directory or handbook was published, total publication expared with $7,760, a decline of $220. Printing costs were higher for the compared with $30,262 for 1942.

Turning now to the explanation of the statement of our financial condition (see Auditor's Report, Exhibit 1), we note the following significant changes:

| Assets | Dec. 12, 1942 | Dec. 11, 1943 | Increase *Decrease* |
|---|---|---|---|
| Current | $ 5,068.56 | $10,576.93 | $5,508.37 |
| Investments, at cost | 66,207.18 | 63,893.85 | *2,313.33* |
| **Liabilities** | | | |
| Current | 4,014.43 | 4,125.62 | 111.19 |
| Unearned income | 3,151.92 | 3,573.28 | 421.36 |
| Life memberships | 3,400.00 | 3,225.00 | *175.00* |
| Surplus | | | |
| Balance at beginning of period | 60,243.63 | 59,217.01 | *1,026.62* |
| Transfers from life memberships | | 175.00 | 175.00 |
| Net income or *loss* for period | *1,026.62* | 2,798.10 | 3,824.72 |

The tables below show changes in our investment portfolio, together with income and the rate of return on the cost of securities from 1925 to date.

The most conspicuous change during the past year is the decrease of our total stock and bond holdings at cost and their increased market value; e.g., in 1942 $66,207 at cost price were worth $58,211 in the market, and in 1943, securities which cost $63,893 were worth $66,012.

We started the fiscal year with investment holdings costing $66,207.18, sold or had called securities costing $7,688.33, and bought $5,373 worth of securities (see Report of Finance Committee), making a net reduction of $2,313.33 in the cost price of our portfolio, which now amounts to $63,893.85. This amount taken from the investment account, plus a net gain of $594.09 on sale of securities and the $3,132.16 interest and dividends, was all put into the funds of the Association to use for general purposes.

The rate of return on our investments for the year 1943 is 4.90 per cent on a cost basis, or 4.89 per cent on the market value.

Respectfully submitted,

JAMES WASHINGTON BELL, *Treasurer*

INVESTMENT PORTFOLIO

| Year | At Par | Cost | | | Market |
|---|---|---|---|---|---|
| | Bonds | Bonds | Stocks | Total | Stocks and Bonds |
| 1925 | $25,000 | $24,661.75 | | $24,661.75 | |
| 1926 | 27,000 | 26,623.25 | | 26,623.25 | |
| 1927 | 29,000 | 28,688.45 | | 28,688.45 | |
| 1928 | 29,000 | 28,633.45 | | 28,633.45 | |
| 1929 | 31,000 | 30,569.48 | | 30,569.48 | |
| 1930 | 31,000 | 32,439.48 | | 32,439.48 | $32,635.40 |
| 1931 | 39,500 | 39,134.48 | | 39,134.48 | 32,307.44 |
| 1932 | 40,500 | 41,134.48 | | 41,134.48 | 33,239.70 |
| 1933 | 33,500 | 32,962.48 | $ 3,954.23 | 36,916.71 | 31,522.50 |
| 1934 | 31,500 | 30,989.48 | 3,954.23 | 34,943.71 | 34,714.00 |
| 1935 | 16,000 | 15,280.48 | 28,114.50 | 43,394.98 | 50,338.72 |
| 1936 | 17,000 | 16,260.13 | 33,712.57 | 49,972.70 | 62,991.00 |
| 1937 | 20,000 | 19,160.91 | 37,399.20 | 56,560.11 | 52,064.75 |
| 1938 | 22,000 | 20,180.95 | 38,302.20 | 58,483.15 | 58,598.88 |
| 1939 | 22,000 | 20,039.57 | 41,155.95 | 61,195.52 | 61,529.38 |
| 1940 | 25,000 | 22,519.80 | 41,155.95 | 63,675.75 | 60,553.88 |
| 1941 | 25,000 | 22,439.81 | 41,155.95 | 63,595.76 | 58,606.11 |
| 1942 | 27,000 | 24,651.12 | 41,556.06 | 66,207.18 | 58,211.88 |
| 1943 | 28,000 | 23,822.54 | 40,071.31 | 63,893.85 | 66,012.12 |

RETURN ON INVESTMENTS

| | Bonds | Stocks | Total | Rate of Return on Cost |
|---|---|---|---|---|
| 1925 | $1,350.00 | | $1,350.00* | |
| 1926 | 1,410.00 | | 1,410.00* | |
| 1927 | 1,524.70 | | 1,524.70† | |
| 1928 | 1,642.77 | | 1,642.77† | |
| 1929 | 1,575.44 | | 1,575.44† | |
| 1930 | 1,695.21 | | 1,695.21 | 5.22% |
| 1931 | 1,886.81 | | 1,886.81 | 4.82 |
| 1932 | 2,014.36 | | 2,014.36 | 4.89 |
| 1933 | 1,679.49 | $ 108.57 | 1,789.06 | 4.84 |
| 1934 | 1,593.13 | 218.07 | 1,811.20 | 5.18 |
| 1935 | 1,022.96 | 680.70 | 1,703.66 | 3.92 |
| 1936 | 801.77 | 1,597.63 | 2,399.40 | 5.00 |
| 1937 | 884.87 | 2,689.62 | 3,574.49 | 6.31 |
| 1938 | 928.04 | 2,063.02 | 2,991.06 | 5.11 |
| 1939 | 978.79 | 1,781.52 | 2,760.31 | 4.51 |
| 1940 | 1,037.56 | 2,182.46 | 3,220.02 | 5.06 |
| 1941 | 1,088.97 | 2,497.35 | 3,586.32 | 5.64 |
| 1942 | 1,306.49 | 2,186.17 | 3,492.66 | 5.28 |
| 1943 | 1,133.97 | 2,094.47 | 3,228.44 | 4.90 |

* Estimated income for year.
† Certificate of deposit interest included.

## REPORT OF THE FINANCE COMMITTEE

During the past fiscal year ending December 11, 1943, the following changes have been made in the investment holdings of the Association:

| *Securities Sold or Presented for Payment When Called* | *Cost* | *Sale or Call* | *Net Profit or Loss* |
|---|---|---|---|
| *Bonds* | | | |
| $1,000 Dominion of Canada | $ 802.85 | $ 893.73 | $ 90.88 |
| 2,000 Nevada-California Electric Corp. | 1,895.40 | 2,045.00 | 148.60 |
| 2,000 Paramount Pictures | 2,000.00 | 2,060.00 | 60.00 |
| 1,000 United Stockyards Corp. | 905.33 | 1,015.00 | 109.17 |
| | $5,603.58 | $6,013.73 | $ 408.65 |
| *Stocks* | | | |
| 15 shares Chesapeake and Ohio Ry. | $1,328.25 | $1,612.50 | $ 284.26 |
| 1 share Erie Railroad Co. | 120.98 | 44.43 | *76.55* |
| Total stocks | $1,449.22 | $1,656.93 | $ 207.71 |
| Total bonds | 5,603.58 | 6,013.73 | 408.65 |
| | $7,052.80* | $7,670.66† | $ 616.36† |
| Loss from conversion of Standard Brands | | | *22.27* |
| | | | $ 594.09 |

* Does not include $35.53 reduction in capital value of Standard Brands stocks and cash refund on odd share.
† After deducting fees and commissions.

| *Purchases* | *Cost* |
|---|---|
| $4,000 Chicago, Milwaukee, and St. Paul R. R. | $2,375.00 |
| 3,000 U. S. Treasury 2% | 3,000.00 |
| | $5,375.00 |

Listed below are the bond, preferred stock, and common stock holdings of the Association. This table shows the total costs of our present holdings, together with market values of December 11, 1943, and of December 2, 1942.

### BONDS

| *Par Value* | | *Int. Rate* | *Due* | *Cost* | *Value Market or Last Sale 12/2/42* | *12/11/43* |
|---|---|---|---|---|---|---|
| $2,000 | Central Illinois Electric and Gas Co., 1st Mtg. | 3¾ | 1964 | $ 2,010.00 | $ 2,102.50 | $ 2,124.00 |
| 4,000 | Chicago, Milwaukee and St. Paul Railroad | 4 | 1989 | 2,375.00 | | 2,800.00 |
| 3,000 | Chicago, Terre Haute and Southeastern Railway Co., 1st and Ref. | 5 | 1960 | 2,012.12 | 1,860.00 | 2,220.00 |
| 1,000 | Erie Railroad Co., 1st Consol. Mtg. | 4 | 1995 | 883.26 | | 1,017.50 |
| 2,000 | Grand Trunk Western Railways Co., 1st Mtg., 50-year | 4 | 1950 | 1,855.45 | 1,720.00 | 2,035.00 |
| 1,000 | Interlake Iron Corp., Convert. Deb. | 4 | 1947 | 980.63 | 1,035.00 | 1,025.00 |
| 2,000 | Pennsylvania Railroad Co., Deb. | 4½ | 1970 | 1,913.03 | 1,785.00 | 1,960.00 |
| 1,000 | Pennsylvania Railroad Co., Gen. Mtg., Series "D" | 4¼ | 1981 | 986.50 | 955.00 | 1,061.25 |
| 2,000 | Shawinigan Water and Power Co., 1st Mtg. | 4½ | 1967 | 1,801.15 | 2,022.50 | 2,080.00 |
| 2,000 | St. Louis and Iron Mountain Southern Ry., 1st Mtg. | 4 | 1933 | 935.00* | | 1,840.00 |

| Par Value | | Int. Rate | Due | Cost | Value Market or Last Sale 12/2/42 | 12/11/43 |
|---|---|---|---|---|---|---|
| 2,000 | Southern Railway Co., 1st Consol. Mtg. | 5 | 1994 | 2,070.40 | 1,830.00 | 2,110.00 |
| 3,000 | U. S. Savings Bonds, Series "G" | 2½ | 1954 | 3,000.00 | 3,000.00 | 3,000.00 |
| 3,000 | U. S. Treasury Bonds | 2 | 1953–51 | 3,000.00 | | 3,000.00 |
| | | | | $23,822.54 | $16,310.00 | $26,272.75 |

* $600, or 30 per cent, paid on principal of $1,535.00.

STOCKS

| Number of Shares of Preferred Stock | | Cost | Value Market or Last Sale 12/2/42 | 12/11/43 |
|---|---|---|---|---|
| 14 | Glidden Co. | $ 735.99 | $ 537.25 | $ 644.00 |
| 10 | Household Finance Corp., 5% | 903.00 | 1,035.00 | 1,100.00 |
| 25 | International Harvester Co. | 3,686.63 | 4,088.00 | 4,225.00 |
| *Number of Shares of Common Stock* | | | | |
| 25 | Chesapeake and Ohio Railroad Co. | 1,309.07 | 878.13 | 1,156.25 |
| 55 | Commonwealth Edison Co. | 1,525.51 | 1,168.75 | 1,326.87 |
| 20 | Erie Railroad Co. | 279.13 | 155.00 | 195.00 |
| 50 | General American Transportation Corp. | 3,084.30 | 1,825.00 | 2,037.50 |
| 100 | General Electric Co. | 2,738.19 | 2,900.00 | 3,737.50 |
| 50 | General Motors Corp. | 2,057.47 | 2,055.25 | 2,512.50 |
| 58 | Glidden Co. | 1,635.72 | 841.00 | 1,073.00 |
| 50 | Kroger Grocery and Baking Co. | 1,297.22 | 1,300.00 | 1,593.75 |
| 25 | Liggett and Myers Co., "B" | 2,018.13 | 1,500.00 | 1,600.00 |
| 50 | Link-Belt Co. | 2,524.15 | 1,687.50 | 1,800.00 |
| 50 | Mesta Machine Co. | 2,007.37 | 1,312.50 | 1,375.00 |
| 50 | J. C. Penney Co. | 2,878.28 | 3,775.00 | 4,825.00 |
| 50 | Procter and Gamble Co. | 2,459.72 | 2,462.50 | 2,818.75 |
| 12 | Standard Brands, Inc. | 852.62* | 206.25 | 363.00 |
| 50 | Standard Oil of California | 2,097.27 | 1,312.50 | 1,806.25 |
| 50 | Union Carbide and Carbon Corp. | 2,867.88 | 3,806.25 | 3,200.00 |
| 100 | Wayne Pump Co. | 3,114.65 | 1,750.00 | 2,350.00 |
| | Total Stocks | $40,071.31 | $34,595.88 | $39,739.37 |
| | Total Bonds | 23,822.54 | 16,310.00 | 26,272.75 |
| | Total Security Holdings | $63,893.85 | $50,905.88 | $66,012.12 |

* $22.27 deducted from $888.15 in adjusting holdings

The composition of the investment account remains approximately 60 per cent stocks and 40 per cent bonds, net changes having increased bond holdings only slightly.

Market values have improved this year compared to last (see Treasurer's Report), the effect being noted in the bond account. Income from interest and dividends has fallen below the 5 per cent rate but still remains favorable both on cost and market bases. Many second grade bonds are being called as the market improves, and replacements of this character are not readily available. Proceeds have been invested in United States Government bonds.

Respectfully submitted,

ROY C. OSGOOD, *Chairman*
CHARLES C. WELLS
JAMES WASHINGTON BELL

# REPORT OF THE AUDITOR

December 21, 1943

*Executive Committee,*
*American Economic Association,*
*Evanston, Illinois*

DEAR SIRS:

In accordance with instructions we have examined the accounts and related records of the American Economic Association for the period from December 12, 1942, to December 11, 1943, and now submit our report thereon together with the following exhibits:

| | |
|---|---|
| Balance Sheet—December 11, 1943 | Exhibit 1 |
| Statement of income and expenses for the period from December 12, 1942, to December 11, 1943 | Exhibit 2 |

*Results from Operations*

Net income for the fiscal year ended December 11, 1943, was $2,798.10 compared with a net loss of $1,026.62 for the preceding fiscal period as shown in the following summary:

| Particulars | Year Ended Dec. 12, 1942 | Year Ended Dec. 11, 1943 | Increase *Decrease* |
|---|---|---|---|
| Income: | | | |
| Dues | $17,612.16 | $18,484.52 | $ 872.36 |
| Interest and dividends | 3,391.36 | 3,132.16 | *259.20* |
| Other (net) | *201.44* | 594.09 | 795.53 |
| Total income | $20,802.08 | $22,210.77 | $1,408.69 |
| Expenses: | | | |
| Administrative and other operating expenses | $ 7,760.24 | $ 7,540.70 | *$ 219.54* |
| Publication expenses | 22,501.87 | 20,939.77 | *1,562.10* |
| Publication income | *8,433.41* | *9,067.80* | *634.39* |
| Total expenses | $21,828.70 | $19,412.67 | *$2,416.03* |
| Net income or *loss* | *$ 1,026.62* | $ 2,798.10 | $3,824.72 |

The increase in income from dues reflects the increase in membership of the Association during the period under review. Membership at December 12, 1942, and at December 11, 1943, as reported by the Secretary, was as follows:

| Classification | Number of Members Dec. 12, 1942 | Number of Members Dec. 11, 1943 |
|---|---|---|
| Members— | | |
| Regular | 3,457 | 3,630 |
| Junior | 114 | 62 |
| Family | 28 | 36 |
| Life | 37 | 33 |
| Honorary | 17 | 16 |
| Complimentary | 18 | 21 |
| Totals | 3,671 | 3,798 |

Interest on bonds owned was accounted for and dividends received on stocks were compared with amounts reported in published records of dividends paid. Securities costing $7,088.33 were sold during the year for $7,682.42 resulting in a gain of $594.09.

Administrative and other operating expenses, as detailed in Exhibit 2, aggregated $7,540.70 compared with $7,760.24 for the previous fiscal period.

Net publication expense, as shown in the following summary, amounted to $11,871.97 for the current period as compared with $14,068.46 for the preceding period:

| Particulars | Fiscal Year Ended Dec. 12, 1942 | Fiscal Year Ended Dec. 11, 1943 | *Review* Budgetary Estimates for 1943 |
|---|---|---|---|
| Expenses: | | | |
| Printing of— | | | |
| *Review* | $ 9,114.46 | $ 9,440.84 | $8,000.00 |
| *Proceedings* | 3,909.79 | 3,652.56 | |
| *Handbook* | 1,775.72 | | |
| Editor's honorarium | 2,500.00 | 2,500.00 | 2,500.00 |
| Payments to contributors | 1,760.00 | 1,855.25 | 1,500.00 |
| Editorial clerical salaries | 2,986.25 | 3,045.90 | 3,200.00 |
| Editorial supplies and expenses | 373.23 | 404.15 | 300.00 |
| Sundry publication expenses | 82.42 | 41.07 | |
| Total expenses | $22,501.87 | $20,939.77 | |
| Less—Income: | | | |
| Subscriptions, other than from members | $ 5,899.15 | $ 6,402.00 | |
| Sales of copies | 932.28 | 1.160.17 | |
| Advertising | 1,601.98 | 1,505.63 | |
| Total income | $ 8,433.41 | $ 9,067.80 | |
| Net publication expense | $14,068.46 | $11,871.97 | |

The December issue of the *Review* had not been printed at the time of our examination. Printing expenses and cost of paper for this issue have been estimated on the basis of the September, 1943, issue of 5,700 copies. The following estimated costs are included above:

| | |
|---|---|
| Printing—5,700 copies | $1,920.00 |
| Paper | 540.00 |
| Payments to contributors | 450.00 |
| Reprints | 90.00 |
| Total | $3,000.00 |

A net decrease in publication expenses results from the fact that a handbook was published in September, 1942, while there was no similar expenditure in 1943.

*Financial Condition*

Condensed balance sheets of the Association at December 12, 1942, and December 11, 1943, are compared below:

| Assets | Dec. 12, 1942 | Dec. 11, 1943 | Increase *Decrease* |
|---|---|---|---|
| Cash on deposit | $ 3,555.73 | $ 8,063.04 | $4,507.31 |
| Receivables, net | 944.17 | 1,118.92 | 174.75 |
| Inventories | 568.66 | 1,394.97 | 826.31 |
| Furniture and fixtures, net | 679.89 | 598.36 | *81.53* |
| Investments, at cost— | | | |
| Bonds | 24,651.12 | 23,822.54 | *828.58* |
| Stocks | 41,556.06 | 40,071.31 | *1,484.75* |
| | $71,955.63 | $75,069.14 | $3,113.51 |
| **Liabilities** | | | |
| Accounts payable | $ 2,429.22 | $ 3,000.00 | $ 570.78 |
| Allied Social Science Associations | 1,585.21 | 842.41 | *742.80* |
| Tax withheld from employees | | 283.21 | 283.21 |
| Unearned income | 3,151.92 | 3,573.28 | 421.36 |
| Membership extension fund | 2,137.27 | 1,920.13 | *217.14* |
| Fund for proposed secretariat | 35.00 | 35.00 | |
| Life memberships | 3,400.00 | 3,225.00 | *175.00* |
| Surplus— | | | |
| Balance at beginning of period | 60,243.63 | 59,217.01 | *1,026.62* |
| Net income or *loss* for period | *1,026.62* | 2,798.10 | 3,824.72 |
| Transfers from life memberships | | 175.00 | 175.00 |
| | $71,955.63 | $75,069.14 | $3,113.51 |

Cash on deposit was satisfactorily reconciled with balances confirmed directly to us by the depositories.

We did not confirm the receivables of the Association by correspondence with the debtors. In view of the Association's past experience the reserve for doubtful accounts appears to be adequate to cover losses.

Inventory of paper stock was confirmed by George Banta Publishing Company. Stamped envelopes were examined at the office of the Association. Inventory of *Economic Essays* was reduced to a nominal value of $1.00 last year. The Secretary reported 380 copies on hand at December 11, 1943, compared with 402 copies at December 12, 1942.

Changes in the investment accounts were vouched by examination of broker's invoices and other supporting data. Securities held were confirmed directly to us by the State Bank and Trust Company, custodian for the Association.

Insofar as we were able to ascertain, all liabilities of the Association at December 11, 1943, are reflected in the accompanying balance sheet and the Secretary has represented to us that to the best of his knowledge all liabilities are disclosed.

During the year four names were removed from the life membership list and the amount of the individual contributions ($175.00) was credited to the unappropriated surplus account.

We wish to take this opportunity to express our appreciation of the courtesies and co-operation extended to our representatives during the course of the examination.

Very truly yours,

David Himmelblau & Co.
Certified Public Accountants

## EXHIBIT 1

### American Economic Association
### Balance Sheet—December 11, 1943

*Assets*

| | | | | |
|---|---|---|---|---|
| Current Assets: | | | | |
| Cash in bank— | | | | |
| State Bank and Trust Company, Evanston | | $ 3,258.82 | | |
| Madison-Crawford National Bank, Chicago | | 4,804.22 | $ 8,063.04 | |
| Receivables— | | | | |
| Interest accrued on bonds | | $ 286.64 | | |
| Membership dues | | 251.25 | | |
| *Review* advertising | | 463.63 | | |
| Publication sales | | 248.46 | | |
| Total receivables | | $ 1,249.98 | | |
| Less—Reserve for doubtful accounts | | 131.06 | 1,118.92 | |
| Inventories— | | | | |
| Paper stock | | $ 1,086.33 | | |
| Stamped envelopes | | 307.64 | | |
| *Economic Essays*—at nominal value | | 1.00 | 1,394.97 | |
| Investments, at Cost: | | | | |
| Bonds | | $23,822.54 | | |
| Stocks | | 40,071.31 | 63,893.85 | |
| Furniture and Fixtures (less reserve for depreciation) | | | 598.36 | |
| | | | $75,069.14 | |

*Liabilities, Funds and Surplus*

| | | | |
|---|---|---|---|
| Current Liabilities: | | | |
| Accounts payable | | $ 3,000.00 | |
| Allied Social Science Associations | | 842.41 | |
| Tax withheld from employees | | 283.21 | $ 4,125.62 |
| Unearned Income: | | | |
| Membership dues | | $ 550.65 | |
| Subscriptions | | 3,022.63 | 3,573.28 |
| Membership Extension Fund | | | 1,920.13 |
| Fund for Proposed Permanent Secretariat | | | 35.00 |
| Life Memberships and Surplus: | | | |
| Life memberships | | $ 3,225.00 | |
| Unappropriated surplus— | | | |
| Balance December 12, 1942 | $59,217.01 | | |
| Transferred from life memberships | 175.00 | | |
| Net income for period from December 12, 1942 to December 11, 1943 (Exhibit 2) | 2,798.10 | 62,190.11 | 65,415.11 |
| | | | $75,069.14 |

## EXHIBIT 2

### American Economic Association
### Statement of Income and Expenses
### Period from December 12, 1942 to December 11, 1943

| *Particulars* | | | | *Amount* |
|---|---|---|---|---|
| INCOME: | | | | |
| Dues— | | | | |
| Regular, junior, and family memberships | | | $18,294.52 | |
| Subscribing and contributing memberships | | | 190.00 | $18,484.52 |
| Other sources— | | | | |
| Investments— | | | | |
| Interest on bonds | | $ 1,133.97 | | |
| Dividends | | 2,094.47 | | |
| | | $ 3,228.44 | | |
| Less—Custodian's fee | | 96.28 | $ 3,132.16 | |
| Net gain on sales of securities | | | 594.09 | 3,726.25 |
| Total income | | | | $22,210.77 |
| EXPENSES: | | | | |
| Administrative and other operating expenses— | | | | |
| Secretary's salary | | $ 1,500.00 | | |
| Office salaries | | 3,478.95 | | |
| Postage | | 409.14 | | |
| Stationery and supplies | | 244.58 | | |
| Telephone and telegraph | | 45.04 | | |
| Insurance | | 254.50 | | |
| Exchange | | 48.66 | | |
| Provision for depreciation | | 81.53 | | |
| Annual meeting | | 505.30 | | |
| Executive committee expenses | | 645.52 | | |
| Other committee expenses | | 94.27 | | |
| American Council of Learned Societies—dues | | 75.00 | | |
| Program expenditures for 1943 meetings | | 57.75 | | |
| Miscellaneous | | 100.46 | $ 7,540.70 | |
| Publication expenses— | | | | |
| Printing of— | | | | |
| *Review* | | $ 9,440.84 | | |
| *Proceedings* | | 3,652.56 | | |
| Editor's honorarium | | 2,500.00 | | |
| Payments to Contributors | | 1,855.25 | | |
| Editorial clerical salaries | | 3,045.90 | | |
| Editorial supplies and expenses | | 404.15 | | |
| Sundry publication expenses | | 41.07 | | |
| Total publication expenses | | $20,939.77 | | |
| Less—Publication income— | | | | |
| Subscriptions, other than members | $6,402.00 | | | |
| Sale of copies | 1,160.17 | | | |
| Advertising | 1,505.63 | 9,067.80 | 11,871.97 | |
| Total expenses | | | | 19,412.67 |
| Net income (Exhibit 1) | | | | $ 2,798.10 |

## REPORT OF THE COMMITTEE ON THE FOCUSING OF INFORMED OPINION

On an affirmative vote on Professor Frank D. Graham's motion, at the business meeting held in Washington, January 6, 1943, the incoming president was instructed to appoint a committee to consider the possibilities of focusing and making the informed opinion of our membership more effective in matters of public policy. The undersigned members of the Association were designated, by the president, to form the committee, and wish to report as follows:

Since the charter provides that our Association, as such, shall take no partisan attitude, nor commit its members to any position on practical economic questions, it is clear that, as an Association, we are precluded from making any pronouncement on any matter of public policy. Your Committee believes, however, that the Association could perform a valuable public service by offering to designate, from among the members of the Association technically expert in any given field, *ad hoc* independent committees to study, and publish a report upon, any matters of public importance in economics.

For this purpose your Committee recommends that the Association establish a special standing committee on appointments to the aforesaid *ad hoc* independent committees, with instructions that, so far as possible, all academically respectable views on any posed controversial question be represented on such *ad hoc* committees, and that each of such *ad hoc* committees include some members not committed to any particular position on the matter in hand.

Your Committee further recommends that the process of investigation shall be initiated on written petition signed by any twelve members of the Association and addressed to the Association's President; that, on receipt of such a petition, the President, after consultation with the Executive Committee, shall refer the matter to the standing committee on appointments, for designation of an appropriate *ad hoc* committee to report on the question, or shall refuse so to refer it to the standing committee and state, to the signers of the petition, the reasons for such negative action.

If outside funds are available, or can be found, your Committee is of the opinion that the *rapporteur* of each of the *ad hoc* committees, and, perhaps, each of the other members of those committees, should be paid a modest sum for his work, that the reports should be circulated to all the members of the Association for any comment that any member may wish to make, and that, in the light of the comments received, they should be revised, by the *ad hoc* committees, before being published. It is, perhaps, to be expected that differences of opinion will develop within the several committees and, if so, divergent opinions might well be expressed according to the method employed in Supreme Court decisions that fall short of unanimity.

Your Committee is of the opinion that, in such manner, the Association might focus informed opinion and make effective the technical competence of its members in matters of public importance such as, for instance, fiscal policy

in war and peace, international monetary proposals, the control of industries affected with a public interest, the general relations of government to industry, unemployment, and similar matters.

The prevailing public confusion on important issues is of grave concern to all intelligent citizens since it is now all but impossible for political leaders to discover the consensus of informed opinion on any question with which they are called upon to deal. In these circumstances your Committee feels that the Association has an opportunity, and an obligation, which it cannot afford to neglect.

FRANK D. GRAHAM, *Chairman.*
HARRY D. GIDEONSE
C. REINHOLD NOYES

## REPORT OF THE REPRESENTATIVE OF THE ASSOCIATION ON THE NATIONAL BUREAU OF ECONOMIC RESEARCH

Upon our entry into the war, it was expected that the work of the National Bureau, both in research and in publication, would have to be curtailed, especially because of the draft which government services and the armed forces would make upon its permanent staff. Instead, activity has increased, though its direction has, to a considerable extent, temporarily changed. The Bureau has been able to continue most of the work upon its long-term objectives. It has also been able to be of considerable assistance in special matters to governmental war agencies. And it has been able to add to its regular program the study of a large number of particular problems within its scope which arise from war conditions or which will presumably arise in the immediate postwar period. This actual expansion of the work has been made possible by new recruits to the regular staff and the aid of a number of economists drawn from other institutions and engaged upon specific projects.

Perhaps the most important of the contributions of the Bureau to the understanding of the effect of the war on our economy is the volume called *Fiscal Planning for Total War,* by W. L. Crum, J. F. Fennelly and L. H. Seltzer, which appeared early in 1942 under the sponsorship of the Conference on Research in Fiscal Policy. This study of war-produced income and of the various possible methods of reaching it through taxation or borrowing, in order to "pay as you go" and resist inflationary tendencies, has become a reference book in official circles. If its "counsels of perfection" have not been completely put into practice, it seems at least to have had a considerable wholesome influence.

During 1942 and 1943 a series of *Occasional Papers*—the old *Bulletin*—has been devoted to the subject of, and has been named, "Our Economy in War." Two numbers which belong in this series appeared before the special title was adopted: No. 6, *Uses of National Income in Peace and War,* by Simon Kuznets; and No. 7, *Productivity of Labor in Peace and War,* by Solomon Fabricant. In the new format the series continued with No. 8, *The Banking System and War Finance,* by Charles R. Whittlesey; No. 9, *Wartime Prosperity and the Future,* by Wesley C. Mitchell; No. 10, *The Effect of War on Business Financing: Manufacturing and Trade, World War I,* by Ralph A. Young and Charles H. Schmidt; No. 11, *The Effect of War on Currency and Deposits,* by Charles R. Whittlesey; No. 12, *Prices in a War Economy: Some Aspects of the Present Price Structure in the United States,* by Frederick C. Mills; No. 15, *Railway Traffic Expansion and Use of Resources in World War II,* by Thor Hultgren. In addition, but in the regular series, two other studies of railway traffic by Dr. Hultgren have been published: No. 5, *Railway Freight Traffic in Prosperity and Depression;* and No. 13, *Railroad Travel and the State of Business.*

In the general program it has proved possible to complete and publish a number of reports of research which had been under way before December, 1941. These continue the series of studies on production and productivity, made possible by a grant from The Maurice and Laura Falk Foundation of

Pittsburgh. The three volumes are: *Employment in Manufacturing, 1899-1939: An Analysis of Its Relation to the Volume of Production*, by Solomon Fabricant; *American Agriculture, 1899-1939: A Study of Output, Employment and Productivity*, by Harold Barger and Hans H. Landsberg; and *The Mining Industries, 1899-1939: A Study of Output, Employment and Production*, by Harold Barger and Sam H. Schurr.

In the Financial Research Program, the pioneering series of Studies in Consumer Instalment Financing has been completed, except for the final summary volume, with the publication of Gottfried Haberler's *Consumer Instalment Credit and Economic Fluctuations*, and Ernst A. Dauer's *Comparative Operating Experience of Consumer Instalment Financing Agencies and Commercial Banks, 1929-40* (in press). A new series in this program, called "Studies in Business Financing," has been undertaken. It deals especially with the changes in methods of financing that have taken place in the past two decades, and treats them from the standpoint both of the enterprises and of the banks. Thus it is an exploration of the various forms of credit that may replace, in the portfolios of banks, the "commercial paper" that constituted so large a portion of their assets in the past. It is also an exploration of the possibilities offered to business with limited credit of securing more favorable terms or more extensive "lines" through these new forms. The volumes so far issued are: *Term Lending to Business*, by Neil H. Jacoby and R. J. Saulnier; *Financing Small Corporations in Five Manufacturing Industries, 1926-36*, by Charles L. Merwin; *Accounts Receivable Financing*, by R. J. Saulnier and Neil H. Jacoby; *The Financing of Large Corporations, 1920-39*, by Albert R. Koch; *Financing Equipment for Commercial and Industrial Enterprise*, by R. J. Saulnier and Neil H. Jacoby; and *Financing Inventory on Field Warehouse Receipts*, by Neil H. Jacoby and R. J. Saulnier. An important and distinguished piece of work is *Basic Yields of Corporate Bonds*, by David Durand, which appeared in the series called "Technical Papers."

The Conference on Research in Income and Wealth has published Volumes 4, 5 and 6 of its series of studies: *Outlay and Income in the United States, 1921-38*, by Harold Barger; *Income Size Distributions in the United States, Part I;* and *Studies in Income and Wealth*. The Conference on Price Research has issued its report on *Cost Behavior and Price Policy*.

The policy to be followed by the Bureau under the exigencies of war was settled by its Executive Committee at a meeting held nine days after Pearl Harbor. The declaration of that policy, made by the Director of Research, Wesley C. Mitchell, appeared at the end of his contribution to the report on *Economic Research in War and Reconstruction*, which was issued early in 1942. It reads as follows:

(1) Economic research is a function equally important in war and in peace.
(2) In so far as possible, the National Bureau should be kept intact as a going concern.
(3) Its program should be pushed energetically, because much of it bears directly upon war problems, and all parts will contribute to the understanding and handling of problems of economic re-adjustment after the war.
(4) Whenever the National Bureau can aid in the emergency by adjusting or expediting its work, it should make every effort to do so.

(5) It should help and encourage members of its staffs to participate in the public services wherever and whenever it is clear that an opportunity exists for constructive contributions.

The foregoing review of the accomplishments of the Bureau during the past two war years seems to demonstrate that this policy has been energetically put into practice and has fully justified itself. There have been few two-year periods in the Bureau's history in which its output can rank with this period either in importance or in volume.

C. Reinold Noyes

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## OF THE

# AMERICAN ECONOMIC ASSOCIATION

1944

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